

# **INVESTIGATING NIGERIA'S ASSET MANAGEMENT CORPORATION: CASE STUDY OF A BAD BANK SOLUTION TO BANKING CRISIS**

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## ABSTRACT

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This paper provides an assessment of Africa's first "bad bank," the Asset Management Corporation of Nigeria (AMCON), and its role in resolving non-performing loans (NPLs) in the aftermath of the 2008 financial crisis. It is a case study that primarily investigates the effectiveness of AMCON in addressing the banking crisis in Nigeria based on evidence from different sources ranging from economic indicators to media reports and newspaper interviews. The establishment of AMCON in 2010 helped to resolve the non-performing loans crisis in Nigerian banks, through a transparent removal of toxic assets and by providing the affected banks with a fresh start, while eliciting a minimal moral hazard effect as far as financial institutions were concerned. Other African countries such as Ghana are now considering adopting a similar "bad bank" solution. However, the AMCON solution has been at a considerable cost to the Nigerian taxpayers as AMCON has been running at a huge loss, partly funded by the taxpayer through the government. Data analysed in the study cover the period from 2008 to 2013. The analysis showed that the AMCON solution was successful as the balance-sheet sanitization effort helped to neutralize many of the banking sector's non-performing loans, and spurred improvements in the sector's aggregate loan book quality within its first two years. As at December 2012, AMCON had purchased more than 95% of the banking sector's NPLs, leaving the industry's NPLs at less than 5%. This offered banks a fresh start and the leeway to concentrate on building new and sustainable lending models. This outcome of this study supports prior empirical work which only examined bad banks in developed economies (the USA and Europe) and in the Asia Pacific. It should be noted that the "bad bank" concept is new to Africa and so there is very little empirical work on this topic. This study contributes to the discussion by its exposition on the overall positive trends in Nigeria's banking sector post-crisis and the impressive growth in bank credit, GDP and the equity market after the financial crisis.

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## **LIST OF ABBREVIATIONS**

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AMC – Asset Management Company

AMCON – Asset Management Corporation of Nigeria

ASI – All-Share Index

CBN – Central Bank of Nigeria

EBA – Eligible Bank Assets

EIB – European Investment Bank

EME – Emerging Market Economies

FMF – Federal Ministry of Finance

GDP – Gross Domestic Product

IMF – International Monetary Fund

MC – Market Capitalization

N – Naira

NDIC – Nigerian Deposit Insurance Corporation

NPL – Non-Performing Loan

NSE – Nigerian Stock Exchange

SEC – Securities and Exchange Commission

## 1.0 INTRODUCTION

An unprecedented financial and credit crisis took place in 2007-2009, beginning in the U.S. subprime mortgage arena. The spill-over effect of the crisis left the global financial markets in a state of disarray. By 2009, global economic growth had shrunk, for the second consecutive year, below the historical average of 4.5% (Financial Derivatives Company, 2013:2). The crisis led to an increase in troubled assets and a rise in corporate default rates, triggering a series of write-offs and resulting in the failure of many world-renowned financial institutions such as Lehman Brothers (Pinedo, 2009:1). The crisis left several economies at the brink of bankruptcy, including Nigeria. This study attempts to investigate the effectiveness of Asset Management Corporation of Nigeria (AMCON) in resolving the resultant banking crisis in Nigeria.

Laeven and Valencia (2010:3-5) noted that among the many causes of financial crises are the following: a combination of unsustainable macroeconomic policies including excessive credit booms; large capital inflows and current account deficits; unsustainable public debt; and balance sheet fragilities, all combined with a variety of political and economic constraints. Laeven and Valencia (2010:3-5) also mentioned that in many such crises, currency and maturity mismatches and off-balance sheet operations of the banking sector are prominent.

The aftermath of the crisis caused several disruptions to emerging market economies (EMEs). According to Soludo (2009:7), the impact of the banking crisis on Nigeria is evidenced by sharp declines in cross-border financing, increases in sovereign spreads and pressures in the domestic

markets and in foreign exchange markets. Several Sub-Saharan African (SSA) countries were affected to various degrees, with their banking systems nearing total collapse. In Nigeria, as with many African countries, the first-round effect was not felt on the economy (Sanusi, 2010:2-5). Sanusi (2010) opined further that the sound macroeconomic policies implemented by the country helped to temper the effect of the crisis. Also, the country's banking system was less integrated with the global financial market. Further, the Nigerian banking system operated with simple financial products and had strong capitalization following the 2005 bank recapitalization exercise. However, Nigeria became affected as the recession in advanced countries deepened, with consequences for the economy as a whole and the financial sector in particular.

### **1.1 STATEMENT OF THE PROBLEM**

Non-performing loans (NPLs) were at the heart of the banking crisis that engulfed the Nigerian financial markets during 2008–10. A sharp deterioration in the quality of banks' assets followed, thereafter resulting in liquidity constraints and capital adequacy problem across all the Nigerian banks (Central Bank of Nigeria, 2011:1). International Monetary Fund (2013:11) identified the following factors as contributing to the Nigerian crisis identified by the authorities include:

- i. Critical gaps in regulatory framework and regulations.
- ii. Macro-economic instability caused by large and sudden capital inflows.
- iii. Lack of investor and consumer sophistication.

- iv. Inadequate disclosure and transparency about the financial position of banks.
- v. Unstructured governance and weak management processes within the CBN.
- vi. Uneven supervision and enforcement, and weaknesses in the overall business environment.

The government, through the central bank, played a leading role in financial system restructuring, including strengthening the legal and regulatory framework, injecting public funds, and setting up a new institution for crisis management.

These findings are in line with the view of Fofack (2005:1), who wrote that there is a greater probability of a banking crisis occurring in Sub-Saharan Africa countries as a result of non-performing loan-related risks. Fofack (2005) stated that this is mainly because the region's banking system is dominated by a few large banks. Healing the banking system is therefore a crucial task for the central banks to ensure sustained recovery. Posen and Véron (2009:1) suggest that any lingering fragility of a country's banking industry would cause persistent disruption and/or misallocation of bank credit, resulting in a significant negative impact on economic activity which in turn discourages investment. Also, Posen and Véron (2009) believe that recurring banking sector fragility will not only reduce aggregate demand but also harm productivity growth since certain investment and R&D cycles will probably be skipped, with capital tending to be misallocated to lower-return projects, and causing long-term unemployment.

There is some consensus that asset management companies (AMCs) have been a consistently successful tool employed by financial institutions and policymakers to resolve insolvent and non-

viable financial institutions, restructure distressed but viable financial institutions, dispose of troubled assets and repair NPLs in banking systems. Aggarwal, Aritomo, Brenna and Clark et al. (2012:3) believe that creating an asset management agency (in other words, using the “bad bank” model) has become the preferred solution. This is validated by Terada-Hagiwara and Pasadilla (2004:8) who stated that theoretically, by removing NPLs from banks and transferring them to AMCs, banks regain the capacity to intermediate funds in the economy. PricewaterhouseCoopers (2009:9) state that during some prior crises, “bad banks” have been used successfully by financial institutions and policymakers to manage and restructure troubled assets on bank’s balance sheets. Schäfer and Zimmermann (2009:9) observed that when the banks are freed of their toxic assets then the threat of bankruptcy, the risk of a reduction in lending due to a lack of capital, and other attendant negative effects, can be minimized or eliminated.

A large body of empirical work has examined “bad banks” in developed economies (the US and Europe) and in the Asia Pacific region. However, the bad bank concept is relatively new to Africa with very little empirical work, if any, as Nigeria’s AMCON is the pioneer public-owned bad bank on the continent.

## **1.2 OBJECTIVES OF THE STUDY**

The objective of this study is to investigate the effectiveness of the Asset Management Corporation of Nigeria (AMCON) in addressing the banking crisis in Nigeria, particularly in resolving non-performing loans in the aftermath of the 2008/9 financial crisis.

This study is intended to be very instructive for the rest of Africa and other developing economies especially now that other African countries are considering adopting the bad bank solution to address their current banking crisis, with Ghana considering the AMC design similar to AMCON's. The major contribution of this research study to this discussion is the exposition on resulting trends in Nigeria's banking sector post-crisis and the extent to which credit growth, GDP growth and equity market size after the financial crisis are explained by the bad bank solution.

The outcome of this research study is expected to assist policymakers, academics, banking institutions, and regulatory bodies in Sub Saharan Africa specifically, as well as globally, to understand the impact of "bad bank" intervention on reported bad debts and NPL ratios in Banks. This study is also expected to improve understanding of how the "bad bank" solution uniquely contributes to reviving the banking system's credit intermediation activities.

The next section of this study, Chapter 2, begins with a literature review on bad banks. Chapter 3 describes the research approach adopted in this study. This is immediately followed with a discussion of Nigeria's financial system and the role played by AMCON to mitigate the impact of the banking crisis on the country's banking sector (Chapter 4). The financial performance and costs of AMCON on the Nigerian economy are analysed in Chapter 5 while conclusions, recommendations and areas for further study are presented in Chapter 6.

## **2.0 LITERATURE REVIEW**

### **2.1 Introduction**

This chapter focuses on the review of relevant literature on bad bank structures and other core aspects of the topic under study. Various issues are covered such as the designs and structures of bad banks, cross-country experiences, and possible rationales that lead to the establishment of bad banks. The chapter thus presents the conceptual and theoretical basis for the study.

### **2.2 Systemic Banking Crisis**

Laeven and Valencia (2010:7) explained that financial crises can be both damaging and contagious, often prompting the need for swift policy responses. They stated that historically, financial crises led affected countries into deep recessions and sharp current account reversals with some crises turning out to be contagious and rapidly spreading to other countries with no apparent vulnerabilities. According to Waxman and Annamalai (1999:3), a “systemic financial crisis” could be defined as a widespread banking failure affecting over 20% of a country’s banking system in terms of total deposits and which results in creditors, depositors, and shareholders all asking for their money from the banks at the same time. A systemic run (banking panic) occurs when bank creditors at all, or several number of banks in the banking system suddenly ask that their debt claims be converted into cash to such an extent that the banks have to close down or suspend convertibility of their debt into cash (Calomiris & Gorton, 1991:5).



According to Laeven and Valencia (2010:7), a banking crisis is defined as systemic if two conditions are met:

- (a) Significant signs of financial distress in the banking system (as indicated by significant bank runs, losses in the banking system, and/or bank liquidations).
- (b) Significant banking policy intervention measures in response to significant losses in the banking system.

Laeven and Valencia (2010) stated further that policy interventions in the banking sector to be significant if at least three out of the following six measures have been used: extensive liquidity support (5% of deposits and liabilities to nonresidents); bank restructuring gross costs (at least 3% of GDP); significant bank nationalizations; significant guarantees put in place; significant asset purchases (at least 5% of GDP); and deposit freezes and/or bank holidays.

Systemic banking crises, when they occur, are usually difficult to handle because they simultaneously cast negative sentiments and doubt on all banks. Caprio and Klingebiel (1997:5-6) claim that handling such crises is even more difficult for less-developed and transition countries. According to Terada-Hagiwara and Pasadilla (2004:5-6), some of the developing countries that experienced systemic crisis in 1997 include Thailand, Korea, Indonesia and Malaysia. Caprio and Klingebiel (1997:5-6) state that these developing countries lack deep capital markets that can spread the costs of insolvency over a number of years. Also, they are often unable to deal with resulting bank insolvencies and may resort to an inflation tax to finance banks' losses. Waxman and Annamalai (1999:12) argued that the experiences of these East Asian countries show that systemic financial crises are inevitable in

developing countries. As such, Waxman and Annamalai (1999:12) advised that these countries must focus on early containment of such crisis. Caprio and Klingbiel (1997:6) state further that failure to confront the problem will only aggravate the banking crisis. This view is supported by Gandrud and Hallerberg (2013:5) who claim that, during such a systemic crisis, debt-holders will doubt the bank's ability to meet its obligations to them. The next section describes the tools that could be used by a central bank to deal with such a systemic banking crisis.

### **2.3 Central bank instruments to deal with the crisis**

Major central banks have taken unprecedented policy actions to address the financial crisis in their various jurisdictions. PricewaterhouseCoopers (2009:5) report that regulators and policymakers across the globe have gone to unprecedented lengths to prevent a total collapse of the financial system and also to maintain the solvency of financial institutions. The responses are usually led by a country's central bank and by regional monetary authorities. For example, this was done in 2010 by the European Central Bank (ECB) to address the sovereign debt crisis in the Euro-Zone.

The monetary policy rate (also referred to as the short-term interest rate by Svensson, 2009:1) has remained the primary monetary policy instrument to ensure financial stability, with communication generally playing a supporting role. In Emerging Market Economies, according to Galati and Moessner (2013:9-11) and Laeven and Valencia (2010:7), policymakers usually respond to the banking crisis with macro-prudential tools such as:

- increasing domestic and foreign currency financing,
- provision of long-term liquidity to banks in support of lending, and

- changes in regulations and reserve requirements, and changes in policy rates .

However, according to some writers (Bernanke & Reinhart, 2004; Gertler & Karadi, 2011; and Laeven & Valencia, 2010), the use of non-conventional tools (which have recently generated much discourse in both research literature and policy debates) can be suitable. This is particularly true for extreme situations when policy rates become ineffective. For example, close to the zero lower bound (ZLB) as interest rates cannot fall below 0%.

Explaining the zero lower bound theory, Svensson (2009:1) began by noting that the main tool of conventional monetary policy is the short-term interest rate, set by the Central Bank. He argued that if inflation is low and economic growth negative, then the Central Bank will cut interest rates to stimulate demand and create higher economic growth. However, there may come a point where interest rates have fallen to zero and therefore, cannot fall any further. This is the zero lower bound (ZLB) rate: here, interest rates have fallen as far as they can. Note that it is considered not practical to have negative nominal interest rates. After all, nobody would lend money at a negative interest rate; a person would be better off just holding cash. This means the Central Bank can no longer use interest rates to stimulate the economy. This is also referred to as a liquidity trap.

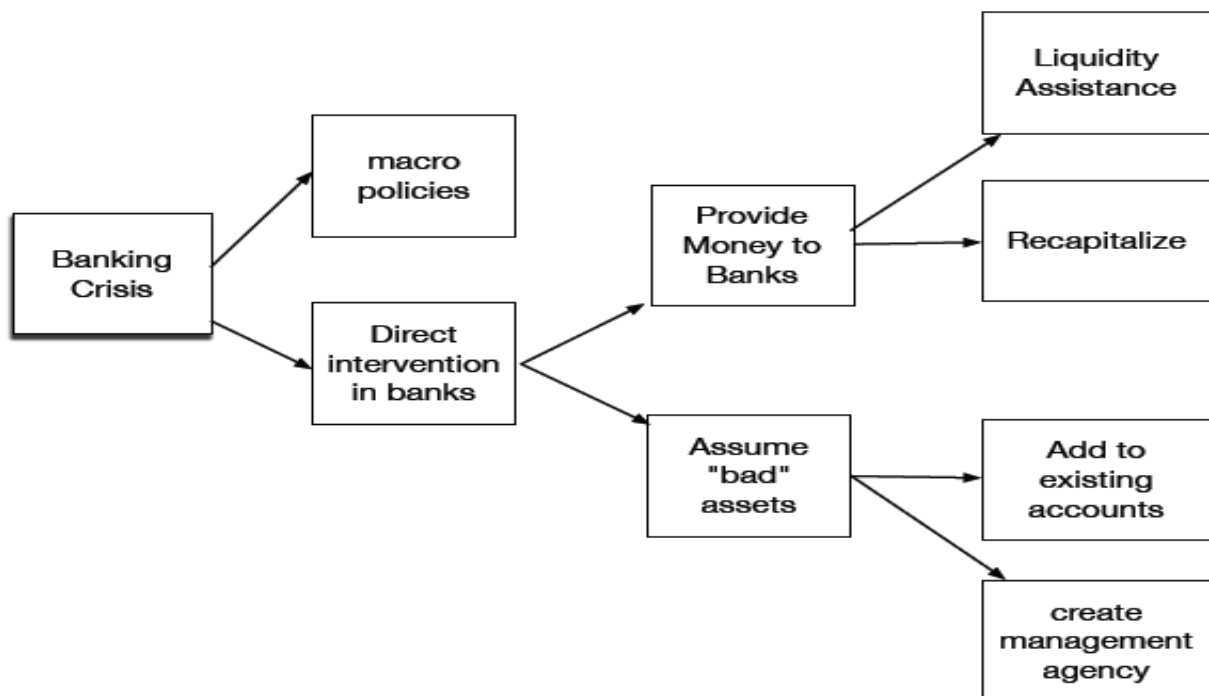
Other unconventional tools that have been widely mentioned include:

- nationalization,
- asset management companies (bad bank),
- asset guarantee programmes,
- purchase of financial assets, and

- lowering of long-term interest rates in order to stabilize specific markets, including those for mortgages.

In discussing probable decisions by government and regulators, Gandrud and Hallerberg (2013:6-7) present the Figure 2.1 below, where the potential action to support the banking system could be to provide liquidity assistance, recapitalize, add to existing accounts or establish an asset management agency.

**Figure 2.1: Banking Crisis Nested Decision-making**



Source: Gandrud and Hallerberg (2013)

## **2.4 The Bad Bank**

### **2.4.1 “Bad Bank Solution” to Financial System Restructuring**

Even before the 2009 economic crisis, bad banks were deployed as an intervention tool by an increasing number of financial institutions and governments. Among the countries where bad banks were deployed were the United States in the late 1980s, Malaysia in the 1990s, and countries in Europe such as Ireland and Germany. After the adoption of the bad bank solution in Nigeria, the number of NPLs which expanded during that country’s crisis has declined.

Gandrud and Hallerberg (2013:1) and Pinedo (2009:1) agreed that a resolution strategy that is often recommended and used by governments to restore the banking sector after crises is to establish a public asset management company (AMC or “bad bank”) that acquires, manages and disposes of impaired bank assets.

Terada-Hagiwara and Pasadilla (2004:3) stated that when debts prove too much for their owners, with an increasing incidence of huge unpaid loans on a bank’s books, many look for a structural solution. PricewaterhouseCoopers (2009:9) state that during some crises, bad banks were used successfully by financial institutions and policymakers to manage and restructure troubled assets on a bank’s balance sheets. PricewaterhouseCoopers (2009:9) established that crisis after crisis, bad banks were consistently and successfully employed by banks and policymakers to dispose of eligible distressed assets.

Aggarwal et al. (2012:3) believe that creating an asset management agency, in other words using the “bad bank model,” has become the preferred solution.

Schäfer and Zimmermann (2009:9) reported that as soon as the affected banks are freed from their bad assets portfolio, then there is usually a reduction and possibly an elimination of the negative effects associated with the constant need to write-down asset values, the threat of bankruptcy, reduction in lending due to a lack of capital and the readiness to take excessive risks at the expense of creditors and the general public.

According to Ingves, Seelig and Dong He (2004:5), AMCs with clearly defined, focused, and consistent goals are more likely to be effective. Ingves, Seelig and Dong He (2004:5) suggested that these goals could be to achieve the following: (a) the resolution of insolvent and non-viable financial institutions; (b) the restructuring of distressed but viable financial institutions; and (c), the privatization of government-owned and government-intervened banks. Ingves, Seelig and Dong He (2004:5) stated further that there are only a few cases where AMCs help to achieve certain social objectives such as in the United States where one of the goals of the Resolution Trust Corporation (RTC) included provision of affordable housing by giving preference to buyers willing to meet programme goals.

#### ***2.4.2 Cross-Sectional Country Analysis of Previous Bad Banks***

Over the years, several countries have used the bad bank solution to address their financial crises. According to Aggarwal et al. (2012:3), as many as fifteen bad banks have been created in recent times. For example, in Asia, countries that have used bad banks to solve their NPL problems include Thailand, Korea, Malaysia, Indonesia, and the People's Republic of China which established four bad banks. In Central Asia, Mongolia, Kazakhstan, and Kyrgyz Republic have all used the AMC solution at

some point. In Europe, Sweden, Spain, Ireland and the UK have used the bad bank solution as recently as the late 2000s while the US also implemented this solution twice to address its financial crisis.

Figure 2.2 below gives a cross-country presentation of selected AMCs and their respective summary.

**Figure 2.2: Selected Historical Bad Banks by Country**

Country	Bad Bank(s)	Summary
Ireland	Sunrise: 2009 Name: NAMA	NAMA is a state-run bad bank established to acquire local real-estate credits that are mostly long-term assets, taking them off bank's balance sheet in order to revive lending in the Irish economy  Volume: EUR90billion.
USA	Sunrise: 1989 Name: Resolution Trust Corporation (RTC)	RTC was established to resolve the loans crisis and large losses afflicting Savings & Loans (S&L) institutions in the US in late 1980s. RTC took over 747 bankrupt S&L institutions between 1989 and 1995.  Volume: US\$394 billion.
	Sunrise: 2008 Name: TARP	TARP was established after the Emergency Economic Stabilization Act of 2008 was passed to alleviate the US subprime mortgage crisis. Institutions rescued included GM, Citigroup and AIG. TARP addressed the US Treasury's urgent need to restart lending, specifically by capital injection and not by purchase of bad asset.  Volume: US\$475 billion.
	Sunrise: 2008 Name: Troubled Assets Relief Program (TARP)	
Spain	Sunrise: 2012 Name: SAREB	Sociedad de Gestion de Activos procedentes de la Reestructuración Bancaria (SAREB) was established to acquire troubled assets from 4 Spanish banking institutions. Owned 55% by private investors and 45% by the state, SAREB has a 15 year life and has already taken over assets in excess of EUR40billion.  Volume: EUR100 billion.
Sweden	Sunrise: 1992 Name: Securum and Retriva	Securum and Retriva were both created in the early 1990s to resolve the toxic assets problem in Sweden and encourage flow of deposits and market confidence. Securum took over about 21% of Nordbanken bad assets (about 3000 NPLs in 1,274 troubled companies) while Retriva acquired 45% of the distressed assets in Gota Bank (now NordeaBank).  Volume: SEK51 billion.
UK	Sunrise: 2010 Name: UK Asset Resolution	UK Asset Resolution, a state-owned limited company was established to manage the assets of the two bankrupt nationalized mortgage lenders Bradford & Bingley and Northern Rock (Asset Management)  Volume: GBP77 billion.
Malaysia	Sunrise: 1998 Name: Danaharta	Pengurusan Danaharta is Malaysia's bad bank to alleviate the effects of the Asian crisis of late 1990s. Danaharta helped to rid financial institutions of troubled assets and maximized the recovery value of their NPLs. About 3000 NPLs were dealt with and Danaharta reportedly had a 58% "final lifetime Loan Recovery Rate" surpassing the 20-50% range achieved by other similar sister Asian bad banks in the same periods.  Volume: US\$13billion.
Korea	Sunrise: 1997 Name: KAMCO	Korea Asset Management Company is a perpetual restructuring agency first established as a NPL management fund in April 1962, reestablished for the same purpose in November 1997 and converted to a bad bank in April 1999. It helped Korea address its NPL portfolio amounting to around 27% of GDP as of March 1998. KAMCO successfully reduced NPLs to total loans ratio from 17% in March 1998 to 2.3% by end of 2002.  Volume: KRW110trillion.

Source: Author's Research Work (2014)



## 2.5 Major success factors for Asset Management Companies

According to Schäfer and Zimmermann (2009:9), Fung et al., (2004:14) and Ingves et al., (2004:13), the following factors are prerequisites for the successful operation of an AMC.

**Sound governance:** To succeed, the AMC should have sound corporate governance, proper internal control systems and effective external supervision. It must also be subjected to regular independent audit. For AMCON, PriceWaterhouseCoopers (PWC) have been engaged as auditors and AMCON's financial statements have, to date, been audited by them (AMCON Annual Accounts, 2012:4)

**Clear AMC mandate:** It is important that the AMC has clear objectives regarding its operation. For example, there must be clear objectives regarding the type of assets that will be eligible for acquisition, and the resolution methods. AMCON's primary purpose which is to stimulate the recovery of the Nigerian financial system is clearly stated and backed by its enabling laws.

**Sound and effective legal infrastructure:** A supportive and effective legal system, which grants special legal powers that include bankruptcy and foreclosure laws to the AMC, helps the AMC to execute its mandate and to achieve a higher recovery rate more rapidly. AMCON was established by an enabling Act, the AMCON Act 2010 which was signed into law on July 19, 2010.

**Strong political will:** It is important that an AMC should operate with strong political backing, sufficient independence, and freedom from political pressure. AMCON thus has the full backing and

guarantee of the Federal Government of Nigeria and remain independent of any political pressure. AMCON is led by a Board which includes the Managing Director of AMCON and representatives from the Federal Ministry of Finance (FMF), the Central Bank of Nigeria, (CBN), the Stock Exchange Commission, and the Nigerian Deposit Insurance Corporation (NDIC). All members of the AMCON Board are appointed by the President of the Federal Republic of Nigeria, subject however to confirmation by the Senate.

**Explicit government financial support:** It is highly preferable that government should finance an AMC's operations directly. Whenever an AMC has to issue its own debt instead, it should have an explicit guarantee by the government in order to strengthen the financial position of the AMC. AMCON's initial funding was provided in the AMCON Act – N 10 billion contributed evenly by the Ministry of Finance ("MOF") and Central Bank of Nigeria (AMCON, 2013:10). Also, the AMCON bonds are guaranteed in full by the Federal Government of Nigeria and bear the full faith and credit of the Federal Government of Nigeria (FGN) in accordance with the provisions of Section 26(I) and 27 of the AMCON Act, 2010 and Section 47 of the Fiscal Responsibility Act, 2007.

**Functional capital market:** A well-functioning and efficient capital market is needed to facilitate speedy asset disposition by the AMC. In addition, the market should encourage foreign investors to purchase assets from the AMC especially in a less developed domestic capital market. AMCON bonds may be traded on the Nigeria Stock Exchange and / or Over-The-Counter in the same manner as FGN, Sub-national and bonds utilizing the CBN or Nigeria inter-bank settlements System for settlement arrangements AMCON (2013:35).

**Well-defined AMC tenure:** In general, the AMC should have a limited tenure to prevent it from not taking too long to sell off assets due to the fear of large losses. The tenure should be sufficient to give the AMC the time needed to deal with the assets effectively. Note that the AMCON Act 2010 clearly envisaged that AMCON's tenure would be terminated by 2020 thus complying with this prerequisite.

**Transparency:** The AMC should disclose its audited results periodically, reflecting its operational performance in a manner that is easily understood by the public. AMCON has published its annual financial reports for the years 2011 and 2012 and this reporting is expected to continue through its operational tenure.

**Realistic pricing:** It is generally good practice that assets be transferred to the AMC at market prices. However, incentives such as a profit-loss-sharing agreement can help to facilitate asset transfers.

**Speedy resolution:** The AMC should aim for speedy disposition of acquired assets. Delays due to the need for economic turnaround in order to increase recovery can result in slower resolution and larger losses.

### **2.5.1 Summary of AMCON compliance**

This section presents a summary of how the structure of AMCON and the characteristic and pricing of its bonds comply with the key prerequisites for a successful AMC (AMCON 2013:35).

**LIQUIDITY STATUS** - The Bonds qualify as instruments in which:

- the CBN may invest under the CN Act 2007,
- pension funds may invest under the Pension Reform Act 2004, and
- liquid assets for banks for the purposes of computing liquidity ratios.

**GUARANTEE** - The Bonds issued are guaranteed by the Federal Republic of Nigeria pursuant to Sections 26(1) and 27 of the AMCON Act.

**TRADING & SETTLEMENT** - The Bonds maybe traded on the NSE and / or Over The Counter in the same manner as FGN, Sub-national and bonds utilizing the CBN or Nigeria inter-bank settlements System for settlement arrangements.

**CANCELLATION** - All Bonds issued in certificate form which are redeemed will be surrendered to the registrar for cancellation. All Bonds cancelled will be forwarded to the Issuer and the obligations of the Issuer in respect of any such Bonds shall be discharged

**EARLY REDEMPTION** - The Issuer may, with written notice, redeem the Bonds in part or in whole subject to the Shelf Prospectus

**TAXATION** - The Bonds are exempt from taxation in Nigeria.

## **2.6 Institutional AMC “bad bank” models**

There are two main institutional models of AMCs.

1. Centralized or government funded.
2. Decentralized or privately funded.

### **2.6.1 *Centralized AMCs***

Gandrud and Hallerberg (2013:3) described a public or centralized AMC as an institution established and owned by the government of a country with the objective of acquiring, managing, and disposing of distressed assets. Examples of this type of AMC include the Korea Asset Management Corporation, the Malaysian Danaharta, the National Asset Management Agency (NAMA) in Ireland, the La Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (SAREB) in Spain and the Asset Management Corporation of Nigeria (AMCON).

Terada-Hagiwara and Pasadilla (2004:4) argue that when the bad loan problem is at a systemic level and this is coupled with a weak legal system for debt resolution, then a centralized AMC is usually the most effective. Terada-Hagiwara and Pasadilla (2004:6) noted further that systemic banking problems are characterized by a huge amount of NPLs which makes it imperative that these countries choose a centralized model over a bank-based model. According to Terada-Hagiwara and Pasadilla (2004), in the case of Thailand, the ratio of NPLs to total loans was at its highest level of 43% in 1998 and 39% in 1999: several commercial and hundreds of merchant banks became bankrupt. In the case of Indonesia, government was forced to nationalize a large amount of its financial system over three to

four years. In both countries it was evident that for the banking system to survive, strong government intervention was called for.

Elliott (2009:6) noted that in the early 1990s, Sweden adopted a centralized bad bank approach to restructure the toxic assets of two of its major local banks.

Furthermore, Ingves et al. (2004:10) assert that centralized AMCs are effective in removing NPLs from troubled banks.

### **2.6.2 *Decentralized AMCs and Work-out Units***

Decentralized AMCs may be government-owned or privately-owned. Among the private AMCs, some are independent entities while others are subsidiaries of banks, or work-out units or departments within the bank. Although the decentralized AMCs share certain similarities, especially when designed to address bad assets from specific banks, public decentralized AMCs differ from bad banks and also differ from restructuring units created and controlled by individual private banks to restructure their own private bank.

Two key differences as suggested by Gandrud and Hallerberg (2013:5) include:

- (i) the assumption of risk and gain, and
- (ii) accountability.

In terms of risk and gains for the private decentralized AMCs, Gandrud and Hallerberg (2013:5) stated that these are held by the parent companies. They added that publicly-owned AMCs assume the risks

associated with the disposal of the assets they hold and are accountable to the government or its agency, usually the Ministry of Finance but sometimes another government agency.

In terms of accountability, Gandrud and Hallerberg (2013:5) argued that privately-owned AMCs may have separate management but are accountable to the board of directors except where the bad banks are legally separated from the parent; for example in the case of Citibank, where a legally separate and independent entity within Citigroup was set up with its assets protected by the US Treasury (Aggarwal, Aritomo, Brenna, Clark, et al (2012:21). Gandrud and Hallerberg (2013:5) cited the example of the bad bank created by Germany's Hypo Vereinsbank as a separate division within the bank but still accountable to the Risk Management Group.

Sometimes governments play a part in supporting the private bad bank by implementing asset guarantees in an attempt to reassure depositors. Gandrud and Hallerberg (2013:5) made reference to the Citibank example as a classic case where government guaranteed a portion of the private bad bank's assets. Gandrud and Hallerberg (2013) noted that it is possible for the government to assume the bad bank's risks without sharing in its gains.

According to Martini, Stegemann, Windhagen and Heuser et al. (2009:8), there are four basic structures for creating an individual bad bank or work-out unit. These are determined by the legal structure, which can be either a structured solution or a banking entity, and the degree of balance-sheet consolidation, which can take place on- or off-balance sheet. While internal structures are

simpler to set up, they lack clear legal separation in terms of a clean balance separation and de-consolidation of risks.

**2.6.2.1 On-balance sheet guarantee:** This is a guarantee by the government that helps to protect the bank's portfolio against losses. Martini, Stegemann, Windhagen and Heuser et al. (2009:8) state that this solution typically comes with a second loss guarantee which often serves as the first step towards stabilizing a bank as it allows banks to buy more time until they can develop a more comprehensive strategy. This was the case with Citibank and Royal Bank of Scotland (RBS).

**2.6.2.2 Internal Restructuring Unit:** This structure is likely to be deployed by a private bank when its portfolio of bad and non-strategic assets constitutes a significant proportion (20% or more) of its balance sheet. Martini et al. (2009:8) argue, however, that this on-balance sheet solution may lack efficient risk transfer, but its benefits come in form of a clear signal to the market and increased transparency.

**2.6.2.3 Off-balance sheet SPV:** An off-balance sheet solution helps the affected institution to transfer its toxic portfolio off its balance sheet into a government-sponsored special purpose vehicle (SPV). Martini et al. (2009:8-9) explained that this structured solution is better suited to small and homogeneous sets of assets. However, bank assets are now usually heterogeneous and highly complex, and in view of this, Martini et al. argue that it is now unfeasible to adopt this strategy.

**2.6.2.4 Bad bank spin-off:** This solution ensures maximum risk transfer and improves the "core" bank's strategic flexibility. This is the most attractive option to bank investors. According to Martini et al. (2009:9) this involves disposing the distressed assets into a legally separate or external bad bank and



is the most effective solution. Martini et al stated that the bad bank spin-off is often a last resort mechanism because of (a) complexities surrounding asset valuation and transfer, (b) funding not being readily available, and (c) lack of common legal or accounting systems for asset separation.

## **2.7 Advantages and Disadvantages of AMCs**

Several benefits of AMCs have been discussed by researchers and practitioners and there appears to be reasonable support for the view that AMCs are very effective in systemic bank restructuring. Terada-Hagiwara and Pasadilla (2004:3) established that AMCs can help to halt the debt overhang in the financial system by removing a large amount of the toxic assets from the books of affected banks and thereby freeing up tied capital. These writers report that banks are given a fresh start by “turning a new leaf” more rapidly and they can focus on financial intermediation, which is their core business, since the AMCs take over the restructuring and management of the bad loans in the banking system. Furthermore, Terada-Hagiwara and Pasadilla (2004:3) added that the acquisition of bad loans by the AMC can open up the market for NPLs.

Aggarwal et al. (2012:3) write that the main principle of the bad bank model is to help a financial institution under stress to rebuild trust by clearly segregating weak assets from the rest. According to Aggarwal et al. (2012:3), the separation of the “bad bank” and the “good bank” helps ensure transparency of the core bank’s performance and accelerates the deleveraging process and facilitates quicker restructuring of its balance sheet. Pinedo (2009:2) and PricewaterhouseCoopers (2009:9) affirmed that when banks are free of toxic assets, confidence of the private investor and market can

be quickly re-established, allowing the “good” bank easier access to cheaper capital and resumption of normal lending activities.

However, bad banks do have certain drawbacks. First, very large amounts of capital are needed to create a bad bank, therefore funding of the bad bank has been a major concern for regulators. PricewaterhouseCoopers (2009:9) stated that the issue that often discourages the establishment and implementation of a state-owned bad bank is the scope of troubled assets, invariably requiring an initial capital requirement which often represents a tangible proportion of GDP. The challenge for such a situation is that if a centralized (i.e. sovereign) bad bank is not practicable, then it is highly likely that the available policy options may be ineffective to achieve the required success. Second, the bad bank solution could crystallize losses for the core bank rendering it undercapitalized or insolvent (Elliott, 2009:7). Third, additional costs in the form of moral hazard may result if the conditions for the purchase of toxic assets represent an incentive for banks to rely on government bailouts in the future. Further, valuation of the securities is a major challenge. Fourth, Pinedo (2009:4) highlighted that for illiquid markets, there is a challenge for banking institutions’ interpretations of mark-to-market accounting for assets. The application of mark-to-market accounting has resulted in the announcement of new write-downs each quarter. These write-down announcements sap investor confidence in financial institutions and lead to stock price declines and increased volatility. Uncertainty regarding future losses and whether and when market and asset values will hit “bottom” inhibit private investment in financial institutions. Fifth, Elliott (2009:7) writes that generally, portfolios of bad assets are complex securities whose economic values change in accordance with changing conditions in the housing and credit markets.

## **2.8 Summary and Conclusions**

The main aim of this study is to examine the effectiveness of “bad banks” and there is evidence to show that AMC vehicles, regardless of their structure, are beneficial for removing NPLs from troubled banks and they permit management to focus on the good bank. To support this finding, in Chapters 4 and 5, we will look at AMCON’s restructuring efforts in Nigeria with a view to determining if the “bad bank” solution has helped to rebuild confidence in banks’ balance sheets and the capital markets, facilitated access to refinancing opportunities for borrowers, and prevented job losses in the banking industry.

In concluding this chapter, the advantages and disadvantages of the major AMC types are presented in Table 2.1 as seen below.

**Table 2.1: Advantages and Disadvantages of AMCs**

AMC Type	Advantages	Disadvantages
<b>Centralized</b>	<p>Serves as a vehicle for getting NPLs out of troubled banks, based on uniform valuation criteria.</p> <p>Removal of bad assets from balance sheet.</p> <p>Centralizes scarce human resources (domestic and foreign).</p> <p>Centralizes ownership of collateral, thus providing more leverage over debtors and more effective management.</p> <p>Can be given special legal powers to expedite loan recovery and bank restructuring.</p> <p>No further involvement with assets, which are removed from balance sheet and managed by government AMC.</p> <p>Government will establish legal entity and structure transaction.</p> <p>Government more likely to accept broader scope of troubled asset classes.</p>	<p>Management is often weaker than in private structures, reducing the efficiency and effectiveness of its operations.</p> <p>Such agencies are often subject to political pressure.</p> <p>Values of acquired assets erode faster when they are outside a banking structure.</p> <p>NPLs and collateral are often long-term “parked” in an AMC, not liquidated.</p> <p>If not actively managed, existence of public AMC could lead to a general deterioration of credit discipline in financial system.</p> <p>Cost involved in operating an AMC may be higher than a private arrangement.</p> <p>If dealing with private banks, determining transfer prices is difficult.</p>
<b>Private (&amp; Bank Specific “separate bad bank”)</b>	<p>Institution can structure an ideal solution tailored to a specific portfolio of troubled assets.</p> <p>Bad bank will not face conflicts of interest with troubled asset counterparties and will have time to manage assets.</p> <p>Depending on structure, shareholders may receive interest in bad bank, retaining some potential upside.</p> <p>Permits management focus on good bank.</p> <p>Separate good bank improves rating agency, shareholder, investor and market perception of institution.</p> <p>Private structure will not subject institution to executive compensation and corporate governance requirements.</p> <p>Specialized skill mix.</p> <p>Up-front loss recognition. Cleans up the bank’s books.</p>	<p>Lack of knowledge of the borrower.</p> <p>Bank may not have sufficient capital to recognize up-front losses associated with selling to an AMC.</p> <p>Valuation of assets challenging and highly negotiated; likely to result in either short-term additional write-downs or longer-term opportunity costs</p> <p>May require ongoing management of assets, for example on a contract basis, depending on investors.</p> <p>Establishment of new legal entity may raise regulatory compliance and charter issues</p>
<b>“Within Bank”</b>	<p>Knowledge of the borrower may facilitate debt restructuring.</p> <p>Access to borrower through branch network.</p> <p>Ease of transaction execution — no need to establish separate legal entity; valuation questions simpler.</p> <p>Does not eliminate future option of bad bank.</p> <p>No upfront funding requirement for any guarantor.</p> <p>Guarantee and assets can be restructured.</p> <p>Retention of upside</p>	<p>Long-term nature of guarantee results in longer-term imposition of government rules.</p> <p>Asset management decisions subject to government rules.</p> <p>Assets retained on balance sheet: additional losses to be absorbed; management costs; ongoing management distraction.</p> <p>Does not achieve public separation from bad assets, no good bank boost</p> <p>Does not provide funding, bank must continue to finance the assets</p>

Source: Author’s Research Work (2014), Pinedo (2009:16-18) and Gandrud and Hallerberg (2013:12) adapted

### **3. RESEARCH APPROACH**

#### **3.1 Case study**

This study attempts to provide a balanced assessment of the Asset Management Corporation of Nigeria (AMCON), and its role in resolving non-performing loans in the aftermath of the 2008 financial crisis. AMCON is Nigeria's bad bank and is the first of this kind in Africa. It is still fully-operational, having reached its third full year of operations. For these reasons, coupled with the fact that there is no broad sample as this is an isolated instance, the case study design is therefore adopted for this study.

This case study design is preferred “when the investigator has little control over events; ‘how’ or ‘why’ questions are being posed; and the focus is on a contemporary phenomenon within a real-life context.” (Yin, 2009:2). The primary advantage of a case study is that it provides much more detailed information than what is available through other methods, such as surveys. Case studies also allow a researcher to present data collected from multiple methods (such as surveys, interviews, document review, and observation) to provide the complete story.

For the purposes of this study, evidence from different sources ranging from economic indicators to media reports and newspaper interviews are considered. The indicators used for assessing AMCON's effectiveness are the following: asset quality, bank capital, GDP growth, capital market index, capital flows, bank credit, banking sector liquidity, and AMCON's operational profitability.

The data used in this study were drawn from Bloomberg, Trading Economics, AMCON's annual financial reports and Central Bank of Nigeria statistics covering a five-year period from the beginning of the financial crisis; that is, from 2008 to 2013. However, the analysis of AMCON's operational profitability covers its first two years of operation; that is, from 2011 to 2012. This study could not extend into the 2013 financial year as AMCON's audited financials had not been released by the time this study was performed.

## **4. THE NIGERIAN CONTEXT**

### **4.1 Introduction**

Any case study takes place within a specific context and the results of a case study should never be considered independently from that context. As stated in the preceding chapter, the indicators used in this study for assessing AMCON's effectiveness are asset quality measured in terms of NPL ratio, bank capital, GDP growth, capital market index, capital flows, bank credit, banking sector liquidity, and AMCON's operational profitability.

According to European Investment Bank (EIB), Nigeria's banking system suffered a high level of toxic NPL since the banking crisis of 2008 and in 2009 alone, the banking sector's aggregate loan book quality, as measured by the ratio of NPL to total loans stood at 34.6%. Between 2004 and 2010, the ratio averaged 16.7%. (European Investment Bank, 2013:62). Furthermore, the local economy faltered from the second-round effect of the crisis as Nigeria's stock market collapsed by 70 % in 2008-2009 with many Nigerian banks sustaining huge losses (CBN, 2012:2). According to CBN (2012:2), Nigerian GDP growth was also running below its 5-year average. This scenario underscored the continuing costs and toll of the global crisis on Nigeria. It was also evidence of the repercussions of the unfolding crisis of liquidity, confidence and solvency in the financial system.

In 2010, the National Assembly established the Asset Management Corporation of Nigeria (or "AMCON"), a special purpose vehicle (bad bank), with the aim of addressing the problem of non-performing loans in the Nigerian banking industry, among others.

## 4.2 The Nigerian Financial System

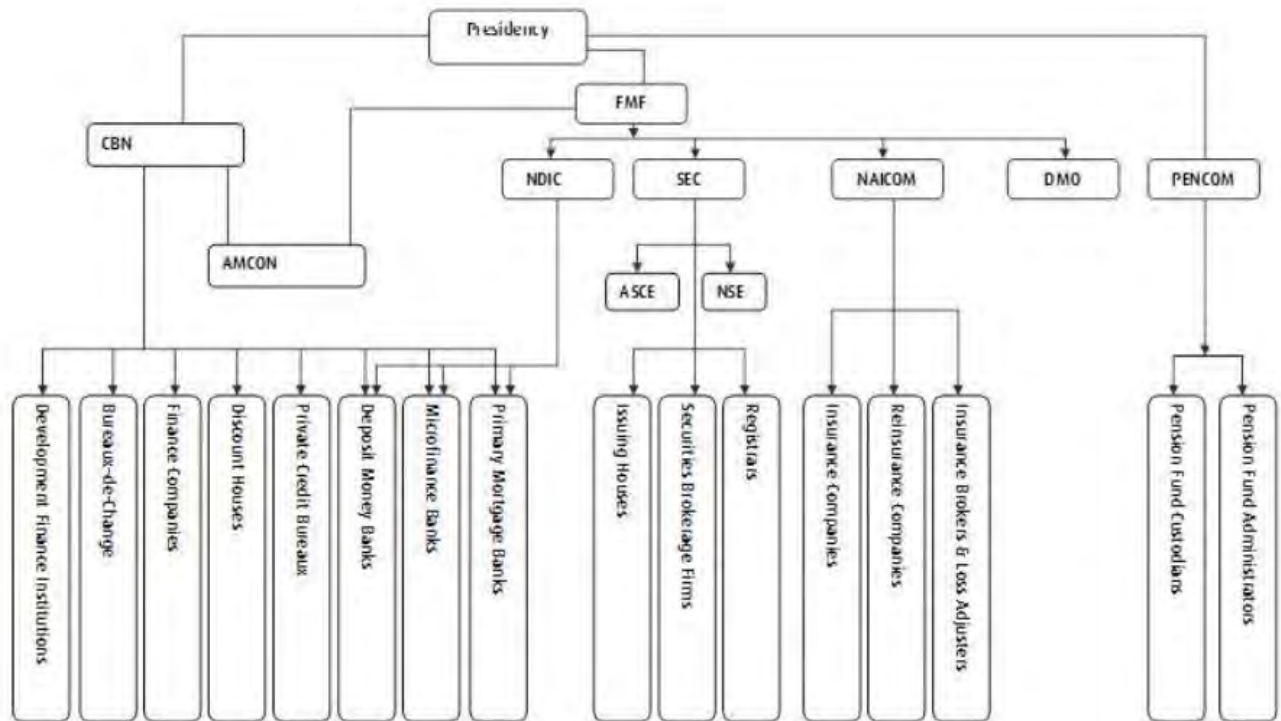
The Central Bank of Nigeria (CBN) is technically an independent regulator, but in practice it works closely with the Federal Ministry of Finance and helps to develop and implement macroeconomic policies. The deposit taking institutions are referred to in Nigeria as deposit money banks (DMBs) and include local banks and branches or subsidiaries of foreign banks. However, the level of foreign ownership is not very high in Nigeria, in contrast to other developing or emerging markets. Currently, foreign-owned banks are limited to Standard Chartered Bank of Nigeria, Citigroup (Nigeria International Bank), Stanbic IBTC (a member of the Standard Bank of South Africa) and Ecobank Nigeria, a subsidiary of Ecobank Transnational Incorporated of Togo.

The regulatory and supervisory institutions consist of the Federal Ministry of Finance (FMF), the Central Bank of Nigeria (CBN), the Securities Exchange Commission (SEC), the National Insurance Commission (NAICOM), the National Pension Commission (PENCOM), and the Nigeria Deposit Insurance Corporation (Ecobank, 2013:2).

Figure 4.1 below depicts the organogram of the Nigerian financial system.



**Figure 4.1: The Nigerian Financial System Structure**



Source: Ecobank (2013)

#### **4.2.1 Nigerian Banking Crisis**

Although the global crisis, with the subsequent drop in stock market indices throughout the world, might have accelerated the onset of the crisis in Nigeria, the Nigerian crisis was largely homemade.

Historically, the Nigerian financial system has been characterized by significant transformations: notably the banking system consolidation of 2005-2006 to address the problem of weak capital base in banks by stipulating a minimum capital base of N25billion (US\$156million) and the banking crisis of 2009 which happened to coincide with the collapse of Lehman Brothers. Particularly, (European International Bank, [EIB], 2013:59) noted that the banking sectors in the other sub-Saharan African

countries remained quite resilient during the period: a situation that placed the Nigerian banking sector in isolation in the region.

According to AMCON (2013:7), Nigerian banks raised over N1.6trillion between 2006 and 2008; banking sector assets as a percentage of GDP increased rapidly to over 60% in 2008. Subsequently, this ratio surged even more to 112% with most of the credit originations and subsequent disbursements in the system coming from margin traders who took positions in Nigeria's equity market and from oil importers who took unhedged positions. When the global financial crisis ripples started spreading, Nigeria's banking sector could not withstand the shocks and consequently most of the credit exposures became "toxic." The damage being caused in the sector prompted the CBN to clamp down on lending malpractices before initiating another round of consolidation (Ecobank, 2013:1).

Other factors contributing to the Nigerian crisis identified by the authorities include:<sup>1</sup>

- i. Critical gaps in regulatory framework and regulations.
- ii. Macro-economic instability caused by large and sudden capital inflows.
- iii. Lack of investor and consumer sophistication.
- iv. Inadequate disclosure and transparency about the financial position of banks.
- v. Unstructured governance and weak management processes within the CBN.
- vi. Uneven supervision and enforcement, and weaknesses in the overall business environment.

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<sup>1</sup> Also see IMF Country Report No. 13/146, 2013. Available: <http://www.imf.org/external/pubs/ft/scr/2013/cr13146.pdf>

#### **4.2.2 Remedial Measures to Mitigate the Impact on the Banking Sector**

The CBN intervened again in 2009 by conducting a sector-wide stress test, in a joint exercise with the Nigerian Deposit Insurance Corporation ('NDIC'). This showed that nine out of the 23 Nigerian banks were technically insolvent and required immediate intervention. According to the CBN, these stress tests highlighted grave issues bordering on capital adequacy and liquidity requirements in banks. The tests also reflected significant weaknesses in financial risk management, corporate governance failures, severe political instability, virulent inflation, worsening economic financial conditions of their corporate borrowers and increasing incidence of fraud and embezzlement of funds, and the use of hedge funds.<sup>2</sup>

This diagnosis led to the introduction of several measures by the CBN between 2008 and 2009. These measures included the following stages, but not necessarily in sequential order:

Phase 1: **Changes in Policy Rates.** The following key measures were changed:

- (a) Monetary Policy Rate (MPR)
- (b) Cash reserve ratio (CRR)
- (c) Liquidity Ratio (LR)

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<sup>2</sup> See <http://www.cenbank.org/out/2011/pressrelease/gvd/press%20statement%20-%20gov.pdf>

The MPR was gradually reduced to 6% from 10.25% between September 18, 2008 and July 7, 2009 and was subsequently raised to 6.25% on September 21, 2010. The CRR was similarly reduced to 2% from 4% and then further to 1%. However, the liquidity ratio (LR) was progressively reduced to 25% from 40% during the same period of time.

**Phase 2: Enforcement of CBN Code of Corporate Governance and Directive to banks to restructure their loan books.** First, the CBN placed much greater emphasis on the enforcement of its Code of Corporate Governance in order to promote transparency and accountability in banks. The CBN also held a review of its contingency plan for dealing with systemic distress in banks.

Second, the CBN issued a directive to banks to restructure their margin loans up to 2009, and expanded its discount window to allow for additional instruments as well as to allow banks to borrow up to 360 days in addition to stoppage of liquidity mopping-up. It was discovered that nine banks were the main users of the Expanded Discount Window (EDW) over a nine-month period ending June 2009. According to Ecobank (2013:3), the CBN injected approximately \$4.2bn into the banks. In July 2009, the CBN closed the EDW.

**Phase 3: Interbank Placement Guarantee Arrangement by the CBN.** After the EDW was suspended, the CBN chose, in place of the EDW, to guarantee interbank placements. Once again, the CBN observed that the same set of nine banks were the major net-takers under the guarantee arrangement.

These measures did not fully resolve the problems in the system as it remained fragile.

At this point it was clear that the issue was far beyond being just a liquidity problem and if drastic actions were not taken, the financial system could collapse. Poor risk management practices were prevalent, in the form of a lack of necessary control measures; thus, the board and management of the banks had failed to observe established controls. CBN thereafter replaced the senior management and executive directors of the affected banks.

**Phase 4: Establishment of AMCON (bad bank).** Following the failure of the various measures in addressing the banking crisis in Nigeria, CBN, the monetary authority, set up the Asset Management Company of Nigeria (AMCON) backed by the AMCON Act 2010 signed into law on July 19, 2010, to swap all the non-performing loans for tradable zero-coupon Federal Government of Nigeria (FGN) bonds. According to Ecobank (2013:3), AMCON made its first bonds issuance in 2010, which was worth US\$5.4bn. By the third quarter of 2012, the value of AMCON bonds had climbed to US\$11bn.

According to CBN (2011:1), the same nine banks were found to be in a grave situation as a result of capital, liquidity and corporate governance concerns. Apart from accumulating high levels of non-performing loans, these banks were seriously exposed to the oil and gas sector as well as to the capital markets. They failed to meet the minimum 10 % capital adequacy ratio and 25 % minimum liquidity ratio. They also accounted for additional losses estimated at over N1.44trillion (US\$9 billion).

The remaining fourteen banks were found to be in a sound financial state and did not require the CBN to take any action.

Other measures also taken by the CBN included developing a macro-prudential framework to address issues such as poor corporate governance, weak risk management practices, poor reporting and lack of enforcement. The CBN also introduced risk-based supervision, reforms in regulations and regulatory framework, and consumer literacy and protection. Furthermore, the universal banking model being practiced after its introduction in 2001 was replaced with a bank holding model under which banks are not allowed to invest in non-bank subsidiaries. The banking industry was also segmented into international, national, regional, specialized and monoline banks with varying capital requirements. Already the guidelines for specialized institutions have been fixed as follows: non-interest bank (regional) - N5 billion (US\$31.25million); noninterest bank (National) - N10 billion (US\$62.5million); and primary mortgage institutions - N5 billion (US\$31.25million);. The commercial banks have also been restructured into regional, national, and international banks with paid-up share capital of N10 billion (US\$62.5million), N25 billion (US\$156.25million), and N50 billion (US\$312.5million), respectively.

The Nigerian experience underlines that rapid changes in market structure have to be carefully monitored and accompanied by the necessary regulatory and supervisory upgrades, as well as proper corporate governance structures.

### 4.3 Rationale for a Public “Bad Bank” in Nigeria

The Nigerian financial system is dominated by the banking sector, which represents about 90% of the assets of the financial system Soludo (2009:4). Soludo (2009) stated further that the banking system accounts for about 65% of the market capitalization of the Nigerian Stock Exchange and that it is the key driver of the economy. Soludo (2009) opined further that new credit to the private sector is expected to exceed the combined spending by the three tiers of government (this was the case in 2008 and never happened in Nigeria before). According to former CBN Governor, Professor Charles Soludo, “Nigeria cannot afford a banking crisis: the non-deficit part of the FGN budget in 2009 is less than banks’ capital; hence the totality of FGN budget cannot recapitalize the banks if the system should collapse. With the drying up of global finance, and non-bank investing public still nascent, the scope for funding any bank bailout in Nigeria is slim - except by ‘printing money’.”<sup>3</sup>

According to AMCON (2013:11), a failure to resolve the banking crisis would have led to the following:

- Continued shutdown of credit markets, and increased job losses.
- A negative impact on Nigeria’s credit rating and risk rating, as a result of banks’ negative shareholders’ funds.
- A negative impact on the real sector. The Intervened Banks had N4.4 trillion (US\$27.5billion) in deposits and Interbank takings, including over N2 trillion (US\$12.5billion) of Public Sector funds. They also had between eight and ten million customers and 50,000 staff.

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<sup>3</sup> Prof. Chukwuma C. Soludo, ex-Governor, Central Bank of Nigeria, “Banking in Nigeria at a time of global financial crisis”, A Presentation at the Special Interactive Session on the Banking System, 30th March, 2009

- Contagion impact on other banks: with total banking deposits of N10.9 trillion (US\$62.5billion).
- Without an AMC, the only option available to the Government would have been to liquidate the Banks through the NDIC.
- As evident from the recently announced NDIC statement, settlement of depositors of failed banks would be at 3 kobo per Naira. Naira is Nigeria's official legal tender and there are 100 kobo in a naira so this represents a 3% return or 97% haircut.
- Diminished confidence shown by foreign creditors and investors

Therefore, the rationale for the establishment of the Asset Management Corporation of Nigeria (AMCON) was timely.

#### **4.4 Asset Management Company of Nigeria (AMCON)**

AMCON is a multipurpose resolution vehicle, which is empowered to purchase non-performing assets from banks, inject needed capital through the issuance of bonds, as well as engender mergers and acquisitions and capital injection by new investors (EIB, 2013:62). AMCON was established to buy the non-performing loans (NPLs) and provide capital for the rescued banks.

##### **4.4.1 *AMCON's role in the Bank Restructuring Process***

The establishment of AMCON was part of a crisis resolution strategy for the broad banking sector and was central to the healthy evolution of the overall financial sector.

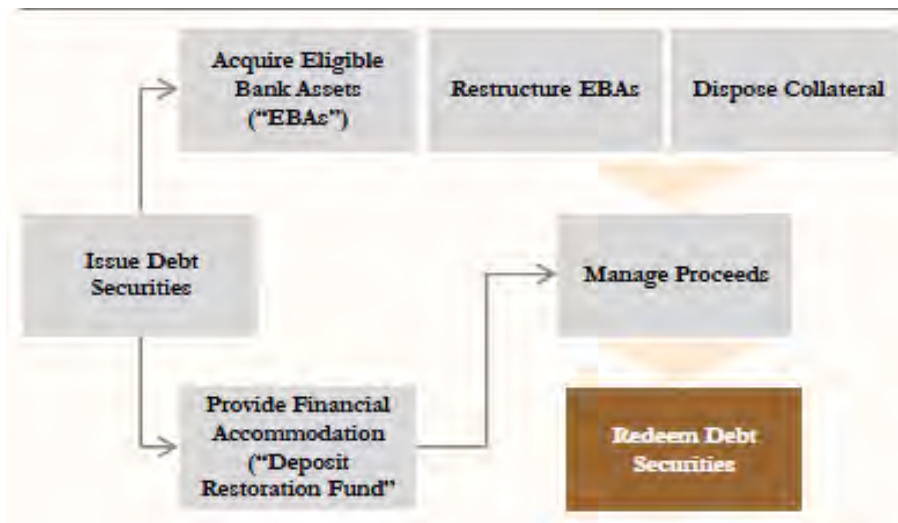


The AMCON Act 2010 was signed into law on July 19, 2010. The intention was that when operational, AMCON would serve as a vehicle to free the banks from the weight of their non-performing assets and would accelerate the process of financial revitalization of the banking sector.

The Banking Supervision Annual Report (2008:65-66) indicated that non-performing credits were approximately 21.6 %, 18.12 %, 8.77 % and 8.44 % in 2004, 2005, 2006 and 2007 respectively. According to Ecobank Research (2013:7), this ratio of nonperformance was 6.3 %, 27.6 % and 15.7 % in 2008, 2009 and 2010 respectively. Provision for bad and doubtful debts grew from N200 billion in 2004 to N400 billion in 2008. Ecobank (2013:7) stated that according to accepted international standards, the maximum acceptable higher limit for the ratio of risky assets (loans and advances) to deposit liabilities is 75% for efficiently run banks.

The main purpose of AMCON is to stimulate the recovery of the Nigerian financial system through the following four activities: providing liquidity to the Intervened Banks and the non-Intervened Banks; providing capital to the Intervened Banks and the non-Intervened Banks; increasing confidence in bank balance sheets; and, increasing access to restructuring/refinancing opportunities for borrowers. The functions of AMCON are described in Figure 4.2 below.

**Figure 4.2: Functions of AMCON**



Source: AMCON (2013)

AMCON released a presentation document in 2013 (<http://www.amcon.com.ng/documents>) which reports that it has to date acquired more than 12,500 Banking sector NPLs worth N1.845 trillion (US\$11.5 billion). The document then reports that by end of 2011, it had already successfully restructured N600billion (US\$3.75billion) of the NPLs acquired.

In December 2010, AMCON started by paying N866.2 billion to purchase Eligible Bank Assets (EBAs) from Eligible Financial Institutions (EFIs).

- In April 2011, AMCON commenced registration for its Debt Issuance Programme and made further purchases of additional EBAs at a purchase price of N377.8 billion.
- In August 2011 AMCON capitalized and acquired three Bridge Banks: Mainstreet Bank, Enterprise Bank and Keystone Bank (referred to as the “AMCON 3”). These were acquired from the NDIC for a total of N765.3billion (c. US\$4.91billion) and prevented a potential liquidation.

- Funds injected into the eligible banks through bond issuances have brought each respective bank's capital back to the minimum capital requirement of N25billion (c. US\$160million) and to the minimum capital adequacy ratio of 10% as stipulated by the CBN.
- AMCON appointed financial advisers to provide advisory services towards determining strategic exit options for AMCON's shareholdings in the Bridge Banks.
- Between September and October 2011, AMCON provided Deposit Restoration Funds to Equatorial Trust Bank, FinBank, Oceanic Bank, Intercontinental Bank and Union Bank through bond issuances of N1.566trillion (US\$10.06billion). This was done to prevent failure of these Intervened banks. All of these banks have been successfully capitalized, with some now merged and others under new management.
- In December 2011, AMCON acquired strategically important EBAs at a purchase price of N748.3 billion.
- In December 2012, AMCON acquired additional EBAs at a purchase price of N75.9 billion.

#### **4.4.2 *Status of AMCON's Acquired Assets***

AMCON recently stated that by October 2013, it had restructured almost 50% of its acquired loans, of which 54% were performing. In the case of the non-performing portion, AMCON acquired the right to call upon the collateral. However, AMCON's preference is to get loans to perform and there is reason

to believe that this could be facilitated by the refinancing arrangement with CBN. Its target is to have restructured 60% of its purchased loans by 2013 year-end.

#### **4.4.3 AMCON'S Governance Structure**

AMCON can be described as a centralized publicly-owned asset management company (Ingves et al., 2004:8). It was established in July 2010. AMCON's primary purpose is to resolve, efficiently, the problems associated with the non-performing loan assets of Nigerian banks.

##### **4.4.3.1 CBN Oversight**

The CBN is responsible for supervising and regulating the activities and functions of AMCON. In carrying out its supervisory role, the CBN may appoint independent examiners to carry out special or routine examinations of the books of AMCON. The CBN may also make regulations to give effect to the provisions of the AMC as and when necessary.

##### **4.4.3.2 Appointment of AMCON Board**

AMCON is governed by a Board of directors. AMCON's Board and Senior Management Team were appointed in the third quarter of 2010. The Board consists of ten members: four executive directors and six non-executive directors. The Board includes the Managing Director of AMCON and representatives from the Federal Ministry of Finance (FMF), the Central Bank of Nigeria, (CBN), the Stock Exchange Commission, and the Nigerian Deposit Insurance Corporation (NDIC).

All members of the AMCON Board are appointed by the President of the Federal Republic of Nigeria, subject however to confirmation by the Senate.

The composition of the Board is as follows:

- I. The Chairman, who is nominated by the Ministry of Finance in consultation with the Minister.
- II. The Managing Director, who is nominated by the CBN.
- III. Three Executive Directors who are nominated by the CBN in consultation with the Minister of Finance.
- IV. Five Non-Executive Directors, two of whom are nominated by the Ministry of Finance, two by the CBN and one by the NDIC.

The oversight functions of the Board are performed through its various Committees:

- I. Board Audit Risk and Compliance Committee.
- II. Board Credit and Asset Management Committee.
- III. Board Compensation and Performance Committee.

#### **4.4.4 *Financing of AMCON***

AMCON's initial funding was provided through the AMCON Act; in terms of that Act, a total of N10 billion was contributed in equal amounts by the Ministry of Finance (MOF) and CBN (AMCON, 2013:10).

AMCON uses funds from three main sources to purchase NPLs from the Nigerian banks and to fund its operations:

- (1) Equity of N10 billion provided by the Federal Government and the CBN (0.22%).
- (2) Zero-coupon bonds valued at N4.04 trillion issued by AMCON (88.80%), and
- (3) debentures issued by CBN; total value of N500 billion (10.98%).

The CBN and Nigerian banks agreed to set up the Banking Sector Resolution Cost Trust Fund. They agreed that for each year, until AMCON has repaid all outstanding obligations, Nigerian banks will contribute 0.50% of their total assets to the Banking Sector Resolution Cost Trust Fund while the CBN will contribute N50 billion per annum for 10 years. The Fund is managed independent of AMCON, with a Board of Trustees to manage and protect the funds. It is anticipated that the contributions will continue for about ten years, but no more than fifteen years (AMCON 2013:18). AMCON stated that the fund will be utilized to make up any shortfall between funds generated from AMCON's operations and the value of bonds to be redeemed or serviced. The Fund is managed independent of AMCON, with a Board of Trustees to manage and protect the funds. It is thus not held by AMCON and there is no mention of same in the reported financials. Note that these are largely AMCON debts to CBN which the CBN expects to recover from AMCON via proceeds from the sinking fund and recoveries

According to Section 14 of AMCON FAQ, the bonds have the full guarantee of the Federal Government of Nigeria (FGN) and legally backed by the AMCON Act, 2010 and also by the Fiscal Responsibility Act, 2007<sup>4</sup>.

Section 13 of the AMCON FAQ, states that...

...“AMCON will redeem bonds through funds obtained from its operations; these funds will include capital gains, divestment/ sale of assets, asset returns, recoveries, sale of loans and investments in Intervened Banks. Subject to the terms of the applicable Pricing Supplement, each bond will be redeemed by the issuer on the maturity date at its final redemption amount (par value)”<sup>4</sup>.

Proshare, a Nigeria-based sell-side research firm, reported on its website on May 17 2013 that AMCON, in consultation with the CBN, initiated a comprehensive plan for refinancing its initial N5.7 trillion zero-coupon bonds maturing from Dec 31, 2013 to Oct 2014.<sup>5</sup>

Proshare ([www.proshareng.com](http://www.proshareng.com)) notes AMCON’s very good progress made on recoveries and restructuring, and the exceptional co-operation of the Money Deposit Banks in fulfilling their commitments to the Financial Sector Resolution Fund – Sinking Fund. Proshare then states that AMCON was able to retire about N2.0 trillion of its bonds during 2013 and 2014 and to refinance approximately N3.6 trillion. Proshare opines that this may help to reduce AMCON’s bond liabilities by about 35% which is well ahead of schedule.

The sources of repayment will be AMCON recoveries and the sinking fund. Consequently, the CBN, which regulates and supervises all contributing institutions including AMCON, is well-placed to ensure that AMCON obtains maximum recoveries and that all banks continue to contribute as agreed.

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<sup>4</sup> See Page 3 of AMCON FAQ. Available at: <http://www.amcon.com.ng/resources>

<sup>5</sup> <http://www.proshareng.com/news/20008/AMCON-announces-Comprehensive-Refinancing-Plans-for-N57trillion-bonds>

Refer to figure 4.3 for the breakdown of AMCON Bonds which AMCON intends to refinance, maturing from December 31, 2013 to November 2014:

**Figure 4.3: Breakdown of AMCON Bond Issuances**

Issuance	Purpose	Discounted Value (₦'mn)	Bond Face Value (₦'mn)	Yield at Issuance (%)	Maturity Date
Series I Tranches I	EBAs Acquisition	866,206	1,164,951	10.125	Dec. 31, 2013
Series I Tranches II	Price Discovery	12,878	17,620	11.800	Dec. 31, 2013
Series I Tranches II	Additional EBAs	377,764	516,864	11.800	Dec. 31, 2013
Series II	Injection in Bridge Banks	736,946	1,001,772	10.500	Aug. 8, 2014
Series III	Deposit Restoration Fund	64,500	88,812	10.500	Nov. 15, 2014
Series IV	Deposit Restoration Fund	1,299,802	1,908,318	13.000	Oct. 31, 2014
Series V Bonds	Additional EBAs, Deposit Restoration Fund	684,091	978,354	13.000	Oct. 31, 2014
<b>Total</b>		<b>4,042,187</b>	<b>5,676,691</b>		

Source: AMCON

- The banks that received these bonds either 1) sold portions to the CBN to raise funds to settle their interbank liabilities and/or 2) kept them on their balance sheets as Held-To-Maturity assets.
- Approximately NGN2 trillion is on the banks' balance sheets while the balance of approximately NGN3.6 trillion vests with the CBN. This applies to the NPLs of N2.5 trillion naira purchased by AMCON with AMCON bonds issued to the banks as the purchase consideration.
- AMCON will retire the NGN2 trillion held by the banks in years 2013 and 2014. The repayments will be effected by a combination of cash and "liquidity status qualifying instruments;" that is, T-bills.



Both AMCON and CBN have stressed that the refinancing will be in a manner consistent with efficient macroeconomic stability ensuring no monetary policy dislocation. That statement is taken to mean that the CBN will not allow cash to flood the market and threaten the naira and hence inflation. The author of this report believes that banks are likely to receive T-bills in exchange for most of their AMCON bonds.

- The redemption of bonds held by banks is expected to be complete by October 2014 at which point the CBN will be sole creditor to AMCON, holding NGN3.6 trillion of bonds.
- The CBN announced that the remaining bonds will be refinanced at the new rate of 6% (currently on offer up to 13%).
- The CBN advised that the AMCON levy, whereby all banks contribute to the AMCON sinking fund, is unlikely to be raised further from the current level of 0.5% of each bank's total assets in the previous year. As at 2012, the levy was lower at 0.3%.

The CBN expects to recover its debt from AMCON via proceeds from the sinking fund and recoveries.

To a large extent, this will become an internal affair between AMCON and CBN.

#### **4.4.5 *The Development of a Market for Distressed Assets***

When AMCON started its operations in December 2010, it had little experience in purchasing and disposing of NPLs. However, AMCON has since put in place a trading and settlement framework; thus, the bonds are tradable on the NSE and/ or over the counter in the same manner as FGN or Sub-national bonds, and bonds utilizing the CBN or Nigeria inter-bank settlements system for settlement

arrangements. The success of this framework will help to establish AMCON as a competent and effective operator in the market for distressed assets.

*A. Purchase of Eligible Bank Assets (i.e. NPLs)*

AMCON's purchase of NPLs is based on certain eligibility criteria. In order to create liquidity in the banking sector, AMCON is empowered to purchase or acquire Eligible Bank Assets (EBAs) from Eligible Financial Institutions (EFIs). To facilitate this process AMCON is empowered to issue bonds or other forms of debt instruments as consideration for the acquisition of toxic assets of banks and other financial institutions. AMCON can exercise discretion in choosing the EBAs to purchase. However the valuation of and subsequent purchase or acquisition of the EBAs are to be determined in accordance with guidelines issued from time to time by the CBN. Eligible for purchase are salable loans whose security rights and transfer are legally executable, as long as those loans are classified as substandard or below. AMCON assigned priority to the purchase of any NPLs if their removal was considered to be critical to the rehabilitation of the institution concerned.

Following acquisition, the EBAs automatically become vested in AMCON, which is then empowered to exercise all the rights and obligations previously enjoyed by the EFIs in relation to those EBAs. Thus, AMCON can: institute court actions to protect, perfect or enforce any existing security rights or obligations; realize any security interests that the EFI could exercise; call up any guarantee; and, exercise all powers conferred by any document that forms part of the bank asset.

AMCON's consideration mechanism for the acquisition of the EBAs centres on the issuance of bonds and other debt securities as consideration for those acquired toxic assets. In carrying out its debt issuance mandate, AMCON is empowered to borrow or raise money with or without the guarantee of the CBN, with the effect that the issuance would be backed by the FGN pursuant to the Fiscal Responsibility Act 2007.

**B. Eligible Bank Assets – EBAs**

AMCON states in its Guidelines that no EFI shall hold on its books EBAs with an aggregate book value exceeding five percent (5%) of the book value of its existing loan portfolio. If an EFI should at any point come to hold more than 5% EBAs, then it must within 30 days offer to AMCON such portion of its EBA holding as is necessary to bring that holding back within the specified threshold of 5%.

These EBAs include:

- a) Collateralised or secured non-performing loans of Eligible Financial Institutions (EFIs) which are substandard, doubtful or lost in accordance with the AMCON Prudential Guidelines, regardless of whether or not they are classified as such by the relevant EFI.
- b) Unsecured non-performing loans of EFIs which are substandard, doubtful or lost in accordance with the Prudential Guidelines regardless of whether or not they are classified as such by the EFI.
- c) Loans (whether collateralised or not) owed to an EFI that is a bank whose banking license has been revoked by the CBN pursuant to the Bank and Other Financial Institutions Act (BOFIA).
- d) Assets acquired by an EFI in the course of the satisfaction of any debt owed to that EFI, whether or not the underlying debt obligation remains outstanding.

- e) Any loan which poses a significant risk to an EFI.

#### **4.4.6 *Special Powers of AMCON***

In addition to its clear purchasing mandate, AMCON has other special powers in certain instances. The AMCON Act 2010 empowers AMCON to act as, or appoint, a receiver for a debtor company whose assets have been charged or mortgaged as security for an EBA acquired by AMCON.

In order to ensure liquidation of debts, AMCON has the power to apply to court by way of a motion ex-parte (without notice to the debtor) for an order vesting it with the possession of the movable or immovable property of the debtor. It also has the power to apply in the same manner for an order freezing the accounts being held in an EFI by the debtor.

#### **4.4.7 *Valuation and Pricing of Eligible Bank Assets (EBAs)***

For margin loans, AMCON valued non-performing loans (NPLs) backed by shares of listed companies at an implied premium of approximately 60% over the 60-day average of 'recent' prices ending November 15th 2010. This applies to intervened and regular banks. NPLs backed by other perfected collateral would be accepted at the most current estimate of the loan value supplied by the EFI concerned. AMCON may elect to verify the value ascribed to the NPLs by the EFI before purchasing the NPLs. EFIs will be liable for wrong values ascribed to NPLs and that liability will be in the form of post-sale adjustment or sale reversal. The post adjustment for valuations given by the EFI will be as prescribed in the CBN Guidelines. Adjustments will be by demand or direct debit from accounts kept with CBN.

Some asset classes require the consent of a regulatory body for any interest in the asset to pass in Nigeria; these include, for example, security over a telecommunications license as this requires the consent of the Nigerian Communications Commission (NCC). Here, upon sale to an operator, the asset will be held as a bare trustee thus divesting the bank of beneficial interest and the legal title will be that of a trustee and not an owner. AMCON predicated this arrangement having received legal advice confirming that trust arrangements are legal and enforceable in Nigeria. In the case of syndicated facilities held by a group of both Intervened and non-Intervened banks and secured by security held by a trustee on their behalf, these facilities will be treated as secured, subject to the condition that AMCON is secured. Such security can be effected either by a deed of ascension or novation or by a deed of assignment and restatement.

Because of the large amount of liquidity to be added to the market, there is a danger of a glut. In other words, a situation where the extremely expansive stance of monetary policy triggers monetary growth well ahead of economic activity, giving rise to substantial excess supply. A liquidity glut is undesirable as it leads to mismatch between unabated desired savings and lower realized investment, as well as between the amounts available for finance and the flow of hard assets to absorb it. This might push long-term real interest rates lower. Against this background the CBN will open a repo window for the purpose of repurchasing the bonds as follows:

- up to 25% of the bonds may be repurchased up to the first anniversary of the bond issuance;
- a further 25% may be repurchased up to the second anniversary; and
- the balance of 50% may be repurchased up to the third anniversary.

According to AMCON, this graduated arrangement, as described above, was implemented after due consideration of the country's macroeconomic outlook.

#### **4.4.8 Recent Changes to AMCON Act**

AMCON is amending its laws with the main objective of legalizing the banks' contributions to the sinking fund. The sinking fund contribution required from the affected banks is currently set at 0.5% of on-balance sheet assets and 0.5% of 33% of off-balance sheet assets. According to Renaissance Capital, this sinking fund rate could be increased in the future. Other aspects of the amendments to the AMCON laws include:

- 1) the process of asset purchases by AMCON;
- 2) giving statutory backing to a proposal to allow the banks' AMCON sinking fund contributions to be treated as allowable deductions for tax purposes;
- 3) the introduction of a default penalty on banks that err in calculating their contributions, and
- 4) defining a finite life span for the sinking fund; for example, a life of ten years starting in 2014, subject to extension for a further five years.

The Act initially establishing AMCON envisaged that its existence would be terminated by 2020. However, AMCON representatives hold the view that AMCON will continue to operate after that; they feel that its continued existence will help to ensure stability of the financial system. However, this writer feels that this continuation would be contrary to the prerequisites for a successful bad bank framework.

#### **4.4.9 Contributions to the Resolution Cost Fund by Nigerian Banks**

In line with Section 65 of the Asset Management Corporation of Nigeria Act, 2010 Amendment bill, 2014, there is the need for the establishment of a sinking fund to check any banking crisis in the country in the future. Nigerian banks were thus mandated by the CBN to contribute to a sinking fund, also known as the Resolution Cost Fund. The fund was set up to assist AMCON to meet its goals and to ensure that government will not bear the cost of any financial crisis in the future. Each bank is required to contribute to the sinking fund 0.5 % of its total assets, which was increased from 0.3 % in 2013, and 0.5 % of 33.3 % of its off-balance sheet assets.

As reported in the Leadership Newspaper of June 2, 2014, fifteen banks have paid the sum of N119 billion to the AMCON sinking fund for the year 2013.<sup>5</sup> The media report stated further that for the year ended December 2013, AMCON's financial statements showed the following payments:

- Access Bank N9.18 billion.
- Diamond Bank N7.6 billion
- Fidelity Bank N4.4 billion
- First Bank N13.85 billion
- Guaranty Trust Bank N8.1 billion
- Skye Bank N10.35 billion
- Stanbic IBTC N3.82 billion
- Sterling Bank N3.11 billion
- UBA N9.67 billion

- Zenith Bank N17.55 billion

Ecobank, FCMB, Union Bank, Stanbic IBTC, Unity Bank and Wema Bank accounted for the balance.

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<sup>5</sup> Sinking Fund: Banks Pay N119bn to AMCON. See <http://leadership.ng/news/372992/sinking-fund-banks-pay-n119bn-amcon>



## **5. DATA PRESENTATION AND ANALYSIS**

### **5.1 Introduction**

This chapter begins with a review of Gross Domestic Product (GDP) growth trends in the Nigerian economy after the establishment of AMCON. This is followed by a review of the capital market and banking sector between 2008 and 2013 and finally, the financial performance and analysis of AMCON is presented.

### **5.2 Nigeria's GDP Growth Trends**

Figure 3.1 below shows the Gross Domestic Product (GDP) growth trends in Nigeria after the AMCON solution was implemented. Information on the GDP Growth Rate in Nigeria is reported by the Central Bank of Nigeria.

The GDP in Nigeria expanded by 7.72% in the fourth quarter of 2013 when compared with the previous quarter. The GDP growth rate in Nigeria averaged 6.80% from 2008 until 2013, reaching an all-time high of 8.60% in the fourth quarter of 2010 and a record low of 4.50% in the first quarter of 2009 while the GDP growth for end-2013 was 6.90% (See [www.worldbank.org/en/country/nigeria](http://www.worldbank.org/en/country/nigeria)).

Note that it could not be ascertained the extent to which AMCON impacted on the changes in GDP over this period. However, since the banking sector is a key driver of the Nigerian economy, the establishment of AMCON was key to ensuring improvements in the economic situation of Nigeria.

**Figure 5.1: Nigerian GDP Growth rate**



### **5.3 Nigerian Banking Sector and Capital Market Trends**

The Nigerian banking sector showed relative soundness and improving trends as at the end of 2011. The regulatory capital to risk-weighted assets (RWA) increased from the 4.2% recorded at the height of the crisis in June 2011 up to 17.8% at end-December 2011. In the same vein, the Tier 1 Capital/RWA ratio improved by 13.6% to 18.1% from 15.9% over the same period (IMF, 2013:10).

A detailed overview of these trends in the capital markets and banking sector is presented below.

#### **5.3.1 Capital Market Recovery**

The sharp drop in both market capitalization and the Nigerian Stock Exchange; All Share Index between February 2008 and April 2009 has been reversed. The improvement in the all-share index (ASI) might not be due to only AMCON but following the AMCON intervention, the Nigerian capital

market has witnessed some stability. On July 28, 2010 market capitalization (MC) stood at NGN 6.33 trillion while the ASI was at 25,889.98. By November 15, 2010, ASI had declined marginally to 25,301.34 while MC increased to N8.08 trillion.

**Figure 5.2: Nigerian Capital Market Trends Q4 2009 – Q1 2014**



Source: Bloomberg

### 5.3.2 Capital Flows Trends

After the AMCON intervention, external exposure to Nigerian banks has improved considerably. At the end of 2010, EXIM Bank's exposure to Nigerian banks increased from US\$403 million to US\$1 billion. The European Investment Bank increased its exposure to Nigerian banks by an additional US\$150 million. The International Finance Corporation (IFC) has also increased its exposure to Nigerian banks. Recently, it has announced its intention to inject US\$300 million credit into two Nigerian banks. This consists of US\$200 million in long-term funding to GTBank and US\$100 million in convertible sub-debt and senior loans to First Bank.

### **5.3.3 Bank Credit Trends**

Credit by non-Intervened banks also rose from N127,270 million in April 2010 to N145,885 million in May 2010, and N218,904 million in October 2010, representing increases of 14.63 % and 50.1 %, respectively. Similarly, the Intervened banks' credit increased from N18,189 million to N27,922 million and N43,371million, representing 53.51 % and 55.33 % increases, respectively. The bulk of the credit went to Oil and Gas, Manufacturing, and Transportation and Storage. In October 2010, aggregate credit grew by 19.69 % which annualizes to 23.63 %. Credit to the private sector grew in July 2009, and declined between January and August, 2010 then rose afterwards. By October 2010, credit to the private sector, core private sector, and government grew by 3.86, 3.07 and 64.02 percent, respectively, on annualized basis.

New credit to the economy increased from N145,459 million in April 2010 to N173, 807 million in May 2010, and N345,998 million in June, 2010 representing increases of 19.49% and 99.1% respectively. It, however, declined to N322, 275 million in October, 2010, representing a decline of 6.85%.

The preceding analysis and explanation points to the effectiveness and success of AMCON in Nigeria as an important tool in the country's financial sector restructuring.

### 5.3.4 Improved Sector Liquidity

AMCON's purchase of NPLs with tradable zero-coupon FGN bonds has contributed significantly to banking sector liquidity, mainly because these bonds qualify for statutory liquidity ratio requirements and also remain tradable.

Since the consolidation of the Nigerian banking sector, overall liquidity has remained robust, averaging 52% between 2008 and 2011 and surpassing the CBN threshold of 30% (Ecobank, 2013:7). Consequently, the proportion of AMCON bonds was about 34% of total liquid assets as at the third quarter of 2012 and contributed about 16% of overall sector liquidity. However, Ecobank noted that if AMCON were to suspend its asset purchase programme today and if its contribution to overall industry liquidity were stripped off, the underlying industry liquidity could easily fall below the statutory 30% threshold.

**Figure 5.3: Liquidity-Based Indicators (%)**

	2008	2009	2010	2011	Jun-12
NPL to Total Gross Loans	6.3	27.6	15.7	4.9	4.3
Liquid Assets (Core) to Total Assets	17.6	16.5	17.2	25.7	24.3
Liquid Assets (Core) to Short -Term Liabilities	24.2	22.3	19.8	31.2	28.1
Average Liquidity	44.17	44.45	51.77	65.69	50.5

Source: Ecobank (2013) Adapted

### **5.3.5 *Asset Quality and Management of NPLs by AMCON***

After the AMCON intervention, asset quality indicators such as NPL/total loans showed a substantial improvement as the ratio declined by 22.5% between June 2010 and December 2010 and by a further 4.9% by December 2011. Improvements in liquidity were also noticeable with the ratio of core liquid assets to total assets showing an increasing trend from 17.2% at June 2010 to 25.7% at December 2011. Over the same period, the ratio of liquid assets to short-term liabilities also increased by 11.8% that is, from 27.91% to 31.2% (IMF, 2013:10).

While the 2008/09 banking crisis was raging, it was discovered that the quality of disclosure by banks was extremely poor. After the CBN audit, about ten banks controlling about 40% of the market were found to have more than 35% of the bad loans in the sector. However, various measures by the CBN such as the creation of AMCON and improved banking supervision have since seen asset quality improve significantly to below the threshold of 5% as at the 2012 year-end (Ecobank, 2013:6).

Alford (2012:14) argued that the non-performing loan ratio for the Nigerian banking industry was 37.1% in June 2010 but this fell to 10.4% after the issuance of AMCON bonds in exchange for NPLs a year later. Alford (2012:14) adds that, in a relatively short time, AMCON successfully removed NPLs from the system.

**Figure 5.4: Asset Quality Indicators**

	2006	2007	2008	2009	2010	2011
Total Loans (NGNbn)	2,840.1	5,250.0	7,411.4	8,451.4	7,166.8	7,312.7
NPLs (NGNbn)	225.1	388.0	463.5	2,922.8	1,077.7	426.0
Shareholders' Funds (NGNbn)	100.0	1,650.0	2,802.0	449.0	959.8	1,934.9
NPLs/Total Loans (%)	7.93	7.39	6.25	34.58	15.04	5.82
NPLs/Shareholder Funds (%)	224.99	23.51	16.54	650.97	112.28	22.01

Source: Ecobank (2013) Adapted

### **5.3.6 Bank Capital Trends**

The bank capital to assets ratio reflects the ratio of bank capital and reserves to total assets. Here the term “capital and reserves” includes funds contributed by owners, retained earnings, general and special reserves, provisions, and valuation adjustments. Similarly, “capital” includes tier 1 capital (paid-up shares and common stock), which is a common feature in all countries' banking systems, and total regulatory capital, which includes several specified types of subordinated debt instruments that need not be repaid if the funds are required to maintain minimum capital levels (these comprise tier 2 and tier 3 capital). The term “Total assets” includes all nonfinancial and financial assets.

A. Bank capital to assets ratio (%)

The following analysis of the bank capital ratio as a percentage of total assets also showed positive trends after the AMCON intervention. By 2011, the bank capital to assets ratio (%) in Nigeria was 3.90. Its highest value over the past eleven years (2002-2013) was 18.50 in 2008, while its lowest value was 3.20 in 2010. As can be seen in Figure 3.5 below for other bank capital-based indicators such as regulatory capital/ RWA and Tier 1 capital/ RWA, regulatory capital – to – RWA grew from 2% in 2010 to 17.7% in June 2012 while Tier 1 Capital –to – RWA improved from 2.2% to 17.85 over the same period.

**Figure 5.5: Capital-Based Indicators (%)**

	2008	2009	2010	2011	Jun-12
Regulatory Capital to Risk-Weighted Assets	21.9	4.1	1.8	17.8	17.7
Tier 1 Capital to Risk-Weighted Assets	21.5	4.9	2.2	18.1	17.8
NPLs Net of Provision to Capital	9.1	106.8	192.7	12.1	6.8

Source: Ecobank Research (2013)



B. Concentration Risks Eased

Ecobank (2013:6) noted that Nigerian banks are now stronger as the 2011 year-end figures showed a total qualifying capitalization of NGN1.90 billion (\$12bn) and that of total adjusted shareholder funds amounting to NGN1.94 billion (\$12.25bn). When viewed against the minimum core capital requirement of NGN25 billion (\$158mn) then this situation is within the acceptable levels of risk for the banking industry in Nigeria. Furthermore, Ecobank (2013:7) highlighted that the ratio of Tier 1 capital/total risk-adjusted assets has also stabilized above the Basel requirement of 8%.

These trends also support the effectiveness of the AMCON solution to Nigeria's banking crisis.

**5.3.7 Cost Efficiency**

The efficiency of Nigeria's banking sector continues to stabilize, especially when compared to the situation prior to the banking consolidation spurred by AMCON's establishment. In 2010, the banking industry witnessed some prominent consolidations and there were many one-off costs related to these acquisitions. The overall effect of these costs is reflected in the sector's cost-to-income ratio which stood at 75.4% by December 2011: the ideal target should not exceed 60% (Ecobank, 2013:6).

Ecobank reports that the sector's cost-to-income ratio dropped to about 65% in the first six months of 2012. As these one-off costs are gradually being integrated, one would expect the cost-to-income ratio to stabilize around the threshold of 60% in the coming quarters and one would expect the underlying industry efficiency also to normalize. It should be noted that employee costs still account

for the largest share of overheads in banks, representing about 45% of total non-interest expenses in the first half of 2012.

The preceding analyses of trends in indicator variables for the capital market, macroeconomic, and banking sector, showed that economic conditions in Nigeria stabilized after the AMCON intervention.

#### **5.4 Analysis of the Financial Performance and Costs of AMCON**

Recently, AMCON announced its audited group financial results for the full year ended 31 December 2012 (FY2012). This was the Corporation's second full operational year in which it undertook its mandate to stimulate the recovery of the Nigerian financial system.

The AMCON Group made a total loss after exceptional items of N792 billion for FY2012 and this compares with a N2,440 billion loss for FY2011. The FY2012 loss arose mainly because of the accrued "interest and similar expenses" of N561 billion (2011: N243 billion) and asset impairment charges of N325 billion (2011: N59 billion) charged during FY2012. The most significant expense under "interest and similar expenses" was the bond discount expense of N532 billion, which represents the cost of financing the purchase of the Eligible Bank Assets (EBAs). Interest income charged only on restructured loans was however not enough to cover the finance cost, which is not uncommon bearing in mind the nature of AMCON's business. It is expected that the gap will be reduced moderately in subsequent periods, when the EBAs are restructured and commensurate interest income is realized. The asset impairment charges of N325 billion were largely precipitated by non-collateralized and margin loans purchased by AMCON.<sup>6</sup>

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<sup>6</sup> See "AMCON 2012 Final Accounts" Available at [www.amcom.com.ng](http://www.amcom.com.ng)

### 5.4.1 Key Results for AMCON – 2012 FY

As reported in the AMCON financial results for FY 2012, the key results are:

#### A Balance Sheet - Key Summary

- Total assets of N2.26 trillion (2011: N1.88 trillion).
- Total liabilities of N5.45 trillion (2011: N4.24 trillion).
- AMCON's issued bonds represent 86% (2011: 99%) of AMCON's total liabilities.

Refer to the adapted screenshot of the AMCON balance sheet below.

Figure 5.6: AMCON's 2012 FYE Balance Sheet

BALANCE SHEET Financial Year Ended	Group 31 Dec 2012 ₦'million	Group 31 Dec 2011 ₦'million	Corporation 31 Dec 2012 ₦'million	Corporation 31 Dec 2011 ₦'million
<b>ASSETS</b>				
Cash and balances with Central Bank of Nigeria	607,954	132,582	500,000	-
Treasury bills	256,903	300,105	131,356	45,050
Due from other banks	233,195	346,158	121,044	30,694
Purchased loans	1,004,031	1,278,198	1,004,031	1,279,425
Loans and advances	367,834	459,091	213,374	198,257
Investment securities	182,299	395,852	56,963	44,006
Investment in subsidiaries	-	-	128,563	222,495
Investment in associates	32,432	13,767	23,081	-
Deferred tax assets	9,091	99,102	-	-
Other assets	21,740	119,814	8,416	11,871
Investment property	86,850	85,258	71,195	44,313
Property and equipment	51,357	108,457	1,311	609
Intangible assets	1,212	2,009	240	-
<b>Total assets</b>	<b>2,854,898</b>	<b>3,340,393</b>	<b>2,259,574</b>	<b>1,876,720</b>
<b>LIABILITIES</b>				
Customers deposits	658,793	1,129,333	-	-
Due to other banks	167,494	85,035	141,081	-
Borrowings	526,453	32,332	518,417	19,507
Current income tax	6,555	10,417	-	-
Other liabilities	255,839	451,804	86,464	37,019
Deferred tax liabilities	294	1,226	-	-
Retirement benefit obligation	298	62,186	21	62
Bonds	4,460,222	3,913,680	4,700,022	4,183,592
<b>Total liabilities</b>	<b>6,075,948</b>	<b>5,686,013</b>	<b>5,446,005</b>	<b>4,240,180</b>
<b>Net liabilities</b>	<b>(3,221,050)</b>	<b>(2,345,620)</b>	<b>(3,186,431)</b>	<b>(2,363,460)</b>
<b>CAPITAL AND RESERVES</b>				
Share capital	10,000	10,000	10,000	10,000
Reserves	(3,228,232)	(2,438,218)	(3,196,431)	(2,373,460)
<b>Total equity</b>	<b>(3,221,050)</b>	<b>(2,345,620)</b>	<b>(3,186,431)</b>	<b>(2,363,460)</b>

Source: AMCON (2013)

## **B      Income Statement – Key Summary**

- Gross earnings increased to N42.96 billion (2011: N4.68 billion) representing an increase of over 800% from FY2011 to FY 2012.
- The operating loss of N505.04 billion (2011: N220.05 billion), showed an increase of 130% between 2011 and 2012. This increase could be attributed, largely, to an increase in interest expense of 139% resulting from an increase in bond coupon accruals.
- AMCON recorded a loss after tax of N822.97 billion (2011: N2.37 trillion). Thus, the loss after tax reduced by 65% in the period FY 2011 to FY 2012.
- The Corporation incurred a N2.11 trillion loss in 2011 as an exceptional charge as a result of the following: mark-to-market losses on Financial Accommodation for Deposit protection reasons made to five Intervened Banks; and, the capitalisation of the three Rescued Banks and other investments.

**Figure 5.7: AMCON's 2012 FYE Profit and Loss Statement**

<b>PROFIT &amp; LOSS STATEMENT</b>	<b>Group</b>	<b>Group</b>	<b>Corporation</b>	<b>Corporation</b>
<b>Financial Year Ended</b>	<b>31 Dec 2012</b>	<b>31 Dec 2011</b>	<b>31 Dec 2012</b>	<b>31 Dec 2011</b>
	<b>₦'million</b>	<b>₦'million</b>	<b>₦'million</b>	<b>₦'million</b>
Gross earnings	217,995	57,325	42,961	4,681
Interest and similar income	164,898	40,724	32,925	4,199
Interest and similar expense	(560,826)	(243,086)	(537,965)	(224,728)
Net interest expense	(395,928)	(202,362)	(505,040)	(220,529)
Fee and commission income	23,335	6,017	963	73
Foreign exchange income	5,333	3,639	4	-
Income from investments	6,919	728	2,776	317
Other operating income	17,510	6,217	74	92
Operating loss	(342,831)	(185,761)	(501,223)	(220,047)
Operating expenses	(124,166)	(71,874)	(13,480)	(7,120)
Asset impairment charge	(325,342)	(59,314)	(314,487)	(32,749)
(Loss)/gain on disposal of investment	(4,843)	-	6,219	-
Share of profit in associates	1,514	813	-	-
Loss before exceptional item and taxation	(795,668)	(316,136)	(822,971)	(259,916)
Exceptional item	-	(2,126,535)	-	(2,113,489)
Loss before taxation	(795,668)	(2,442,671)	(822,971)	(2,373,405)
Taxation	3,987	2,970	-	-
Loss after taxation	(791,681)	(2,439,701)	(822,971)	(2,373,405)
Attributable to:				
Parent shareholders	(792,372)	(2,439,814)	(822,971)	(2,373,405)
Non-controlling interest	691	113	-	-
	(791,681)	(2,439,701)	(822,971)	(2,373,405)
Loss per share - basic/diluted (Naira)	(79)	(244)	(82)	(237)

Source: AMCON

**Figure 5.8: Analysis of AMCON's 2012 Loss**

Details	N'000	N'000	%	Comments
Net Loss for the year		822,971,278		➤ Provision for Purchased Loans as a result of marking to market on collateral value of EBAs against their purchase consideration
Add back gross earnings		42,961,000		
Total costs for the year		865,932,278		
<u>Analysis of Total Costs</u>				➤ Loss on Restructured Loans refers to the loss incurred on the restructuring of purchased loans
Finance Cost (interest on Bonds issued)	537,965,000		62.13%	
Provision for Purchased Loans	137,068,176		15.83%	➤ Provision on Loans and Advances is the provision arising on negotiated loans
Loss on Restructured Loans	112,864,000		13.03%	
Provision on Loans and Advances	50,658,102		5.85%	
Diminution in Value of Long Term Investment Securities	17,174,000		1.98%	➤ Loss on Restructured Loans refers to the loss incurred on the restructuring of other loans
Loss on additional financial accommodation	8,669,000		1.00%	
Overhead Costs	6,975,000		0.81%	
Professional fees paid	6,505,000		0.75%	➤ Overhead Costs refers to Operating Expenses excluding Auditors and Professional Fees paid
Writeback in value of investment in subsidiary	(11,946,000)		(1.38%)	➤ Operations account for only 1.26% of total cost
Total Costs	865,932,278		100.00%	

Source: AMCON

From Figure 5.8 above, it is likely that AMCON over paid for the NPLs it purchased and as such in the second year of operation, asset impairment resulting from negotiated loans, non-performing loans and revaluation losses constitute 38% of the Net Loss reported by AMCON in its 2012 FY results. What is clear though is that AMCON bought four times the volume of non-performing loans that was disclosed to on the books of the banks. This is according to a statement by AMCON Executive Director of Finance, Mofoluke Dosumu in the Vanguard Newspaper of December 17, 2012.<sup>7</sup>

<sup>7</sup> "The non-performing loans that we bought were four times larger. This shows that what was disclosed as NPLs (non-performing loans) on the books of the banks were below what we found when they started selling to us. We bought four times what we initially envisaged." See <http://www.thisdaylive.com/articles/amcon-the-bad-bank-and-the-n2-37-trillion-loss/134327/>

## **5.5 Moral Hazard and the Fiscal Cost of AMCON to Nigeria**

According to AMCON and as agreed by all the banks, Nigerian banks are bearing the funding costs of the exercise as they are paying 0,5% of their total assets as a levy. This levy will span ten years and is expected to minimize the financial burden to the taxpayers. In an interview, Bismarck Rewane, CEO of Financial Derivatives, states that “even though the fiscal cost of the distress resolution option was in excess of N6trillion, in reality the social costs avoided including a run on the banks, far exceeds the financial cost. Also the fact that the banks are bearing the financial burden, the taxpayer and fiscal costs is reduced to zero.” The stigma of being listed by AMCON and CBN as a rescued bank constitutes both a fiscal and social burden.

Terada-Hagiwara and Pasadilla (2004:22) claim that an asset management company (AMC) can trigger bank lending with associated moral hazard whenever the transfer of NPLs to the AMC entails little cost to banks. A classic example of this type of moral hazard is when bank executives are confidently taking risky investments knowing that they would not bear the burden of their recklessness in case of a negative outcome: they believe, however, that in the case of a positive outcome they would be the ones to reap the rewards with huge bonuses and other forms of monetary and social gains. This is why several researchers argue against bank bailouts.

For example, Rosas (2006:1) argues that the huge costs shouldered by taxpayers, and the attendant moral hazard incentives that characterize bank bailouts, call for an explanation of why some governments choose to rescue banks when confronted with a systemic banking crisis (“bailout”) while



others choose to allow failures of insolvent banks ("Bagehot"). According to Rosas (2006:3), governments using the bailout solution (bad bank) are encouraging moral hazard through lengthening the lives of insolvent banks unnecessarily. In the same vein, Schäfer and Zimmermann (2009:4) argued that the removal of toxic assets from a bank's books at zero-cost and the corresponding write-down of assets help to avoid the high expense of pricing distressed assets which will keep the cost to taxpayers low and finally help curtail the risk of moral hazard.

## 5.6 Risks Facing AMCON

AMCON is facing refinancing risks, funding risks, interest rate risks, counterparty credit risks and operational risks. Analyses of these risks and suggested mitigating factors are presented in Figure 5.9 below.

**Figure 5.9 Risks Facing AMCON**

RISKS	DESCRIPTION	MITIGANTS
Refinancing Risk	<ul style="list-style-type: none"> <li>Challenges in refinancing Zero Coupon Bonds when they fall due</li> </ul>	<ul style="list-style-type: none"> <li>More developed, liquid and informed debt market</li> <li>Appointment of Dealers/Market Makers</li> <li>On-going investor engagement</li> </ul>
Funding Risk	<ul style="list-style-type: none"> <li>Risk that liabilities cannot be repaid as they due</li> </ul>	<ul style="list-style-type: none"> <li>Sinking Fund</li> <li>Recoveries</li> <li>Federal Government of Nigeria Guarantees</li> </ul>
Interest Rate Risk	<ul style="list-style-type: none"> <li>Exposure to an adverse change in the market value of financial instruments caused by a change in market price or rates</li> </ul>	<ul style="list-style-type: none"> <li>Asset–Liability Management</li> </ul>
Counterparty Credit Risk	<ul style="list-style-type: none"> <li>A counterparty's inability to make payments or otherwise perform under its contracts with AMCON leading to direct credit exposure as well as open market risk positions</li> </ul>	<ul style="list-style-type: none"> <li>Powers under the AMCON Act</li> </ul>
Operational Risk	<ul style="list-style-type: none"> <li>Risk of loss due to inadequate or failed internal process, people, systems, or external events.</li> </ul>	<ul style="list-style-type: none"> <li>Best Practices in Management, Processes and Policies</li> <li>Access to resources</li> </ul>

Source: AMCON (2013)

## **6. CONCLUSION AND RECOMMENDATIONS**

### **6.1 Introduction**

This study investigates the effectiveness of the bad bank solution in addressing the banking crisis in Nigeria through a balanced assessment of Africa's first bad bank, the Asset Management Corporation of Nigeria (AMCON), and its role in resolving non-performing loans in the aftermath of the 2008 financial crisis. This study is important because Nigeria's economy, the largest in Africa, is powered by its banking sector. The intervention of the Central Bank of Nigeria (CBN) was thus crucial to the survival of this sector.

Implementation of this bad bank solution was effective. The decline in the level of non-performing loans (NPLs) was rapid, particularly in the banking sector. NPLs expressed as a percentage of total loans in the banking sector declined from 27.6 percent in 2009 to 4.3 percent by June 2012. We found that the balance-sheet sanitization effort by the CBN has helped to neutralize many of the sector's NPLs, and spurred improvements in the sector's aggregate loan book quality from 28% in 2009 to 4.3% as at the second quarter of 2012. The capital market and the GDP growth over the period under consideration all showed a positive trend after AMCON was formed. Particularly, after the intervention of AMCON in 2010, the banking industry ratio of non-performing loans to total credit reduced from 34.4% in November 2010 to 4.95 % at the end of 2011. We acknowledge however that the improvement in the GDP and the all-share index could be due to other factors besides AMCON.

Overall, we argue that the AMCON solution was effective in addressing the banking crisis in Nigeria as it led to the cleaning-up of the sector and it gave Nigerian banks the leeway to concentrate on building new and sustainable lending models.

While AMCON improved the affected banks' balance sheets so banks could focus on lending to the real economy and thereby supporting economic growth, our analysis reveals that the cost of the bad bank solution has been huge. According to media reports<sup>8</sup>, Dr. Biodun Adedipe, a financial expert, said that "AMCON's debt is a contingent liability to the government, since AMCON's bonds are backed by the Federal Government of Nigeria (FGN), which implies that in the event of a default, the government will have to settle AMCON's creditors." Despite this however, we note that at this point, there is no adverse moral hazard effect on financial institutions.

AMCON's work is not yet finished: it still needs to dispose of all distressed assets acquired. AMCON has, in the past three years, redeemed bonds on four occasions without default and it plans to redeem an additional N800 billion's worth of bonds this year (2014).

The financial performance of AMCON has been mixed and it has been running at a huge loss. The huge asset impairment charges and revaluation losses reported on its financials suggest that AMCON probably overpaid for the NPLs that it acquired.

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<sup>8</sup> AMCON - Stakeholders bicker over lifespan, performance. See <http://allafrica.com/stories/201405260301.html>

In support of this view, the economist Henry Boyo expressed in one of his articles and quoted in a media report<sup>9</sup>: “that AMCON appeared to have been stampeded to pay for those toxic debts before it even considered the need for proper valuation of the acquired assets; and that AMCON has only lately begun ascertaining the real values of the assets acquired almost three years ago.” It remains to be seen when and how AMCON will eventually turn around its losses as well as its negative equity which is currently at N3.2trillion. These observations do not negate AMCON’s contribution to the resolution of the Nigerian financial sector crisis. They only indicate that the pricing of NPLs during a financial crisis has been and will remain the most difficult challenge for any publicly-owned AMC.

## **6.2 Recommendations**

First, AMCON’s operations should be focused primarily on restructuring the purchased Eligible Bank Assets (EBAs) and meeting its debt obligations: any failure to accomplish this would imply that the nation’s equity market and the entire economy is in danger of facing yet another severe crisis.

Second, AMCON should have a clearly defined lifespan, in order to deliver on its mandate successfully. This is in line with global best practices. Thus, the amendment to the AMCON Enabling Act, giving it perpetual life, could trigger adverse moral hazard effects.

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<sup>9</sup> Stakeholders worry over AMCON time-bomb, call for checks. See <http://dailyindependentnig.com/2013/04/stakeholders-worry-over-amcon-time-bomb-call-for-checks/>

The author also supports the call by the International Monetary Fund in its Article IV Consultation Report for 2012 that the Nigerian government should wind down AMCON within seven years. However to do this effectively, AMCON must put in place an effective exit strategy so that the gains from the bad bank solution can be reaped.

Third and last: to minimize costs to taxpayers, it is recommended that the government stake in AMCON should be sold to the private sector. This would ensure a commercial orientation, thereby creating incentives to focus on core competencies, economize on operating costs, and maximize profits and efficiency. Government intervention should be limited to supporting the private bad bank by implementing asset guarantees in an attempt to reassure depositors as in the case of the Citibank example.

### **6.3 Areas for further study**

AMCON is now into its third year of operation and this review covers only this time period. A comprehensive review of AMCON's operation over a period of five to ten years would have made our findings regarding AMCON's performance and effectiveness more valid.

Also, the future assessment of AMCON's performance should also be analysed from both the cash recovery and asset disposal standpoints.

A review is also needed to ascertain how AMCON will manage its bond liabilities and minimise losses from further bond redemption and to determine whether a government guarantee will be its final resort.

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